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THE COST AND AVAILABILITY OF LIABILITY INSURANCE FOR SMALL BUSINESS

HEARINGS

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

THE COST AND AVAILABILITY OF LIABILITY INSURANCE FOR SMALL BUSINESS

Part 1

NASHVILLE, TN—NOVEMBER 16, 1985
SIOUX FALLS, SD—DECEMBER 23, 1985
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CONTENTS

Page

Statement of Senators:
- Pressler, Hon. Larry, a U.S. Senator from the State of South Dakota, and acting chairman, Committee on Small Business 75, 135
- Sasser, Hon. James R., a U.S. Senator from the State of Tennessee, and acting chairman, Committee on Small Business 1

Statement of:
- Alvine, Frank G., M.D., chairman, Commission on Professional Liability, South Dakota State Medical Association 108
- Anderson, Clifton C., secretary, Farmers Elevator Association of South Dakota, Aberdeen, SD 87
- Bell, James G., executive director, Consulting Engineers Council of South Dakota 232
- Booth, David, chairman, EMPE, Inc., Nashville, TN 48
- Boshers, Evelyn R., president, Association of Family Group and Day-Care Homes, Nashville, TN 44
- Cameron, Bill, chairman of the board and chief executive officer, Cameron Oil, Franklin, TN 52
- Christensen, David, president and chief executive officer, Raven Industries, Sioux Falls, SD 78
- Frazer, Eugene L., Jr., vice president, Shafer Insurance Agency, Knoxville, TN 59
- Hackett, William R., executive director, Community Day Care and Comprehensive Social Services Association, Memphis, TN 37
- Herbst, Cheryl, director, Black Hills Preschool and Child Care Center, Deadwood, SD, accompanied by Janice Crangle 146
- Honerkamp, William, president, South Dakota's Black Hills, Badlands, and Lakes Association, Rapid City, SD 212
- Jensen, Gary D., law firm of Lynn, Jackson, Shultz & Lebrun, P.C., representing the South Dakota State Bar Association 155
- Larsen, Roger D., president, Williams Insurance Agency, Sioux Falls, SD .. 123
- Lee, Kenneth, manager, Pope & Talbot, Inc., Spearfish, SD 149
- Miller, Robert, executive director, South Dakota Municipal League 99
- Neff, John C., commissioner, Tennessee Department of Commerce and Insurance 4
- Oakley, Alan D., partner, Willard Oakley & Son Lumber Co., Nashville, TN 49
- Reinhold, Larry, Rainbow Bible Ranch 241
- Schmid, Chris, president, Schmid Insurance, Rapid City, SD 223
- Shultz, Don, on behalf of Terry Peak Ski Resort 139
- Stephens, J.D., director, Holly Tree Day-Care Center, Franklin, TN 26
- Van Cleave, William, partner, Bandy, Van Cleave & Williamson, Nashville, TN, accompanied by Oran Ward, president, the Crump Co., Nashville, TN 65
- Walker, Susan, director, Division of Insurance, State of South Dakota 118
- Wheeler, Jerry, executive director, South Dakota Truckers Association 95
- Woodsend, Ray, representing the mayor of Rapid City, SD 140
- Yeoman, Dale C., professional accounts manager, Kluthe & Lane Insurance Agency, Rapid City, SD 217

APPENDIX

Statement of John Russell Deane III, counsel, Deane, Snowden, Shutler & Gherardi, Washington, DC 243

Page

Statement of Norman J. Siefken, president, Taylor Lumber & Treating, Inc., Beaverton, OR 245
Letter dated December 23, 1985, from Kay Williams, Williams Crane, Inc., Belle Fourche, SD, to Senator Pressler 250
Letter dated December 20, 1985, from Michael D. Monette, vice president and counsel, Government Relations, Colonial Penn Insurance Co., Philadelphia, PA, to Senator Pressler 251

HEARING DATES

November 16, 1985:
Afternoon session 1
December 23, 1985:
Morning session 75
December 30, 1985:
Morning session 135

THE COST AND AVAILABILITY OF LIABILITY INSURANCE FOR SMALL BUSINESS

SATURDAY, NOVEMBER 16, 1985

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Nashville, TN.

The committee met, pursuant to notice, at 12:30 p.m., in suite 29, Legislative Plaza, Nashville, TN, Hon. Jim Sasser (acting chairman of the committee) presiding.

Present: Senator Sasser.

STATEMENT OF HON. JAMES R. SASSER, A U.S. SENATOR FROM THE STATE OF TENNESSEE, AND ACTING CHAIRMAN, COMMITTEE ON SMALL BUSINESS

Senator SASSER. The hearing will come to order.

This hearing is being held here in Nashville today under the auspices of the Senate Select Committee on Small Business. This is the first of a series of field hearings exploring the crisis in the commercial liability insurance industry. This series of field hearings will be ultimately capped by a hearing in Washington by the full Committee on Small Business of the U.S. Senate.

These hearings are in response to the letters, telephone calls, and personal visits, myself and other Senators have had from small business people who are complaining that their insurance rates have escalated anywhere from 300 percent to 1,000 percent. There appears to be no pattern or relation between risk and rate increases. Indeed, there is no pattern between losses that these individual small business people might have caused their insurance carrier in times past and the increase in their premiums. For example, many small business people are saying that they have not had a claim against their insurance carrier for a number of years; yet, they still find that their rates are going up precipitously—as I said earlier, as much as 1,000 percent.

This is not something that's occurring just here, in the State of Tennessee. It's a problem that is national in scope, and that is the reason that the Committee on Small Business has begun to focus attention on this very critical issue.

I want to thank all of you for giving up a part of your weekend and coming here today. I think the problems facing the insurance industry warrant special attention.

I know that many in this audience who will testify later today have experienced skyrocketing premiums or have had policies canceled. Even the city of Knoxville has canceled its liability insur-

ance and has chosen to become self-insured, simply because of the rapid run-up in their premiums. A number of businesses have chosen to go "bare"; that is, to go uninsured because they cannot afford or they cannot obtain insurance.

These problems affect those inside the insurance industry itself. Among those who have contacted my office are insurance agents who are complaining that they are losing customers as businesses begin self-insuring themselves. Or their customers are saying, "We can't afford insurance; we're just going to take the risk and go without coverage." Insurance agents are concerned not just about their own business, but about the general public. With a number of firms operating without insurance, a threat to the general populace is posed.

The first step in addressing these problems is learning about the situation. That is our purpose today. I want to learn what I can about the causes of the problems in the insurance industry. I want to see just how extensive these problems are here in Tennessee. And finally, I hope to explore what is being done at the State level to combat this crisis and if, perhaps, Federal action might be necessary.

I expect this hearing to lay a foundation for any further action which might be necessary to address the difficulties facing small businesses and insurance agents as a result of this capacity crunch.

Now, before we get into the actual hearing—and I want to speed it up because our distinguished leadoff witness has a conflict this afternoon—we should point out that there are differing theories as to just why the insurance premiums have risen so precipitously. Some suggest that the cyclical nature of the insurance industry itself is the leading culprit. Yet, even those who subscribe to this boom-or-bust answer agree that the current downturn is the worst in this century for the insurance industry. The only worse period, as I recall, was in the San Francisco earthquake at the turn of the century.

Perhaps the leading cause of the severity of this bust period—and I suspect that the witnesses will substantiate that today—is a price war that developed between insurance firms engaged in writing commercial liability insurance during the late 1970's and early 1980's. During this price war, premiums were driven down in an effort to attract the premium dollar. Insurance companies could then invest the premium in a favorable market. What they might be losing in premium returns they were making up on investment returns. However, when interest rates fell during the past few years, insurance company investment income also tapered off. As a result, the insurance industry reported a $3.8 billion pre-tax operating loss last year.

Now, there are those on the other side who contend that the insurance industry is in sound fiscal health. The advocates of this position point to a General Accounting Office report on insurer profitability showing a $300 million profit over underwriting losses last year for the property and casualty insurance industries. And I might say that those who espouse this view are supported by recent trends in the stock market. Just last week, I noticed in the New York Times, on the business page, that among the ten best-performing industry groups in the stock market's latest surge up-

wards, property and casualty insurers were among the top five best performers, registering a 17.4-percent gain between September 26 and November 6. Multiline insurers also fared well, posting a 14.8 percent gain for the same period.

So there is not unanimity as to what has caused the problems plaguing small business. I expect we will hear from witnesses today who will go even deeper into the cause of this crisis.

[The prepared statement of Senator Sasser follows:]

STATEMENT OF HON. JAMES R. SASSER, A U.S. SENATOR FROM THE STATE OF TENNESSEE, AND ACTING CHAIRMAN, COMMITTEE ON SMALL BUSINESS

I want to open these hearings by thanking all of you for taking time out from your weekend to be with us. The problems facing the insurance industry today certainly warrant special attention. I appreciate your willingness to share your thoughts with us.

I know many of you have experienced sky-rocketing premiums or have had your policies cancelled. Those within the insurance industry have also been affected by this crisis. Insurance agents are losing business as customers opt to self-insure or to go without insurance. In short, the turmoil in the business community caused by this cost and availability problem is widespread, and demands immediate attention.

My purpose in being here today is to listen to your comments. I am here to learn what I can about the causes of the insurance industries woes. I want to see just how extensive these problems are here in Tennessee. Finally, I hope to explore what is being done at the State level to combat this crisis.

It may be that what we learn today will point out a need for further State action, or the Federal action is necessary. I expect this hearing to lay a foundation for any further action which is necessary to address the difficulties facing small business and insurance agents as a result of this capacity crunch.

As many of you know, there are differing theories on just why insurance premiums have risen so dramatically. Some suggest that the cyclical nature of the insurance industry is the leading culprit. Yet, even those who subscribe to this boom-or-bust answer agree that the current downturn is the worst this century for the insurance industry.

Perhaps the leading cause for the severity of this bust period is the bitter price war that insurance firms engaged in during the late 1970's and early 1980's. During this price war, premiums were driven too low to cover losses. This was tolerable so long as investment income offset losses. However, when interest rates fell over the past few years, insurance company investment income tapered off. As a result, the insurance industry reported a $3.8 billion pretax operating loss last year.

There are those who dispute this view of the current crisis. They contend that the insurance industry is in sound fiscal health. Advocates of this position point to a general accounting office report on insurer profitability showing a $300 million profit over underwriting losses last year for the property/casualty insurance industry.

Those who espouse this view are also supported by recent trends in the stock market. The New York Times reported this week on the best performing industry groups during the stock market's latest surge upward. Property-casualty insurers were among the top five best performers, registering a 17.4% gain between September 26, and November 6. Multiline insurors also fared well, posting a 14.8% gain for this same period.

While there may be uncertainty over the cause of the current crisis, there is no doubt about its devastating impact on the small business community. Important industry groups such as day care centers and environmental firms are finding it difficult to obtain any insurance in many cases. Manufacturers are facing premium increases over 300% in some cases. The same is true for services and virtually every other industry group.

Faced with prohibitively expensive insurance or unable to obtain any coverage, many firms are gambling with the future of their business by foregoing insurance altogether. Some firms are opting to simply discontinue operations in fields where insurance is difficult to obtain.

These are troubling facts which raise serious policy questions. The prospect of day-care centers and environmental firms shutting down is bad enough. But the far-reaching consequences which follow such shutdowns could well prove devastating.

Therefore, I welcome this opportunity to explore in some depth the full range of issues involved in this crisis. I can think of no better way to begin this hearing than to call on the State commissioner of commerce and insurance, the Honorable John Neff to give us his perspective on this problem.

Senator SASSER. I can think of no better way of starting this hearing than to call on the distinguished commissioner of commerce and insurance, the Honorable John Neff, to give us his perspective on this problem. Commissioner Neff, if you would be good enough to come forward and begin, we would appreciate it.

STATEMENT OF JOHN C. NEFF, COMMISSIONER, TENNESSEE DEPARTMENT OF COMMERCE AND INSURANCE

Mr. NEFF. Thank you, Senator. I appreciate the opportunity to visit with you and with your committee with regard to this very, very important subject matter, and I appreciate your taking me first and moving your time up a little bit. As I told you, I am giving my secretary away at 2:30, and I have that choice, but I must be there.

For the record, my name is John Neff; I am commissioner of the department of commerce and insurance for the State of Tennessee. And we are, of course, the primary regulatory agency for businesses in the State of Tennessee. We handle a number of different things, all the way from boxing to cosmetology to real estate and, of course, insurance. It is our original—and, I guess, the main—thrust of our activity. The business of insurance, as I know you know, is one of the very few industries in the country that is solely regulated by the States. There is relatively little participation by the Federal Government due to the McCarran-Ferguson Act. Over these years—and this has been 100 years now—the industry has been well regulated by the States and the public well served, at least in my opinion. The NAIC, the National Association of Insurance Commissioners, has been in business over 100 years and is extremely well regarded.

As a matter of background, we do regulate the business from basically two areas or directions—two primary thrusts, I guess, is the best way to put it. One is, of course, the surveillance of the industry for solvency. Solvency is the original glue that stuck together the NAIC and the original purpose of the regulation of the business of insurance. And then second, we regulate the business for what we call market conduct; that is, do the insurance companies and does the industry treat our citizens properly in the payment of claims and the handling of premiums and all the rest of the nonfinancial areas of the business.

The NAIC has an elaborate "early warning system." We try to flag companies that are in critical financial condition; and we review through our examination system annually all of the companies that have to file annual reports with our department on a standardized basis.

We also examine and review the companies for market conduct. We do that as something that is an important activity. We have a department of consumer affairs—we call it a policyholder's service section—that handles some 6,000 inquiries a year from citizens across the State on all kinds--some come from your own office; some come from other Congressmen and State legislators.

In addition, one of the major functions of lots of the departments—but not all of them, and they all do it a little differently—is the rate-setting mechanisms. Some States, such as California, have open competition. There is no rate regulation for the companies that sell; they simply let the marketplace determine who, in fact, will charge what for insurance. They regulate almost entirely on market conduct oversight.

Some of them have a very structured and a very comprehensive rate structure, such as Texas, where they have a great, big rating bureau who actually sets the rates in the State.

We have a combination here in Tennessee. We have a "prior approval system" for what we call personal lines; that's the individual's, homeowner's, automobile type of policies, where most citizens have a real personal interest in what's going on. We have a prior approval system. They file with us; we review those rates. We approve them or disapprove them or moderate them or whatever in order to get at rate agreement.

In the case of commercial insurance, we have what is called a "use and file system." A company files a rate; they go ahead and use the rate. They file with us within 15 days; we can approve or disapprove through the hearing route. Or, in some cases, they file ahead of time and we can disapprove ahead of time. We do have that opportunity to review, but they do file with us and go ahead and use the system. If we decide it's unfair, unjust, or discriminatory, then we can take action, whatever we have to take.

There is no rate regulation for life insurance companies in any State that I know of. Life insurance is an open competition rate, and has been very successful that way; there's been no regulation.

The main purpose of this hearing, of course, is to look into the questions of availability and price of commercial property insurance in Tennessee. And there is a problem; there is an honest-to-goodness, real problem. Not only in Tennessee, not only in the United States, but worldwide. It is an international problem. And it is not just a perceived problem.

There have been some moderate increases in personal lines. I don't know of any lack of availability, though, of personal lines. I think that what you're really talking about is commercial business. To give you a little idea, the State Farm Insurance Co. has filed a rate for individual automobile policies for about a 10.7-percent increase and about a 3.0- or 2.7-percent increase in homeowners' rates. And that's roughly about what's gone on in homeowners' and automobiles. Personal lines, actually, over the last 4, 5, 6 years have not even kept up with the rate of inflation, so I think what we're discussing today is the question of commercial insurance.

There has been a substantial reduction in the availability of insurance in certain lines. I think all of you know that such things as day-care centers, truckers, roofers, liquor distributors, contractors general liability, officers and directors liability, those coverages have been very, very difficult to get. And prices, as a result, have risen. Any time you get a shortage of a product you get rising prices and a lack of availability, I don't care what product—whether it's insurance or whatever we're talking about. And there has been great pressure on businesses in attempting to find the insur-

ance, of course, and then in budgeting for the price increases; we recognize that.

The question is, What has caused this? Why has it suddenly risen? What are we doing about it, if anything? I think we do need to talk about the causes, and I will center some attention on this in my speech because two or three of the reasons that you mentioned are precisely what, in our opinion and the opinion of the NAIC and the other people working on this problem for 6 months has caused the problem. There has been abrupt price cutting over the last 4 or 5 years. I think that if a lot of the insureds went back and looked at the level of insurance prices back in 1980 and 1981, they would see there was a tremendous reduction in prices; a 50-percent reduction off the posted lists was practically standard. It was not at all unheard-of to have up to 80-percent cuts in prices. Highly competitive, everybody trying to write insurance at these rates in order to do exactly like you said, take the money and invest it to offset the underwriting loss. What happened is, of course, that the losses got worse than they thought and the investment income then turned downward. The industry loss ratio then went up to about 118 percent; and no matter what you do, if you pay out $1.18 for every $1 that you take in, you have a hard time getting ahead.

At the same time interest rates, which got up to 20 percent, as you know, have turned down now to a current level of around 10 percent, and that is obviously affecting it. This has put the industry in such a position that, for the first time in 50 years—I think it is important to understand this point—for the first time in 50 years, the industry had an aggregate net reduction in surplus. The insurance industry, in order to remain solvent, must keep its writings, its total writings, in some relationship to the capital surplus, usually someplace in the area of three times surplus.

Now, what happens when surplus goes down is, obviously, that writings have to go down. There is always an increasing demand for insurance. This is based on inflation, the growth of business, the number of people. We always have an increase in demand for insurance. So as demand is increasing, you have a restriction of the supply and you have availability problems. And that, of course, has been one of the major factors of what has happened in this business.

Second, and probably as important in the long run as anything, is the awards that come out of the court system. The court system in this country needs a real overhaul. The awards are escalating, and they've been irrational across the country, and somebody has to pay for them. There has been this theory, of course, that insurance companies have deep pockets and "we don't have to worry about it; we can get the money from them." That simply doesn't work very long. Somebody has to pay the premiums to pay those losses.

It appears that the courts have simply decided that they can award an injured party anything they want, including punitive damages. We've seen award after award that is just absolutely ridiculous, and it got to the point where insurance companies, particularly for the general liabilities—which is where we're having the big problems—are unable to estimate their losses. If they can't estimate their losses, they can't estimate their premiums. How can

you charge a finite premium for an infinite loss? Look at what happened in asbestos; look at what's happened in the day-care center problem, the child molestation and all of that kind of thing. It has driven the companies out of the market because they have no idea of what they can charge to cover their losses, and obviously, they have to do that.

It is one thing to insure a house that burns down; when you know how much that house cost, you can come to a rough idea of the loss. It's another thing to try to estimate the cost, or the losses, that can come from underground seepage into a water system. One of the courts ruled—and, as you know, each incident is a separate insurable event—where they ruled that each sip of water is an incident and is covered by a separate coverage in the policy. Well, that gets to be ridiculous, but that's the kind of thing that has happened.

I think we all know that, particularly in commercial insurance, the reinsurance market plays a very important part in this overall picture. Almost every risk is reinsured in the reinsurance market. When a primary carrier writes a given policy, such as, say, a $25 million policy on a contractor, that policy is reinsured out in the general marketplace. What has happened is that there has been a worldwide reduction in reinsurance capacity. The largest reinsurer that's around is, of course, as we all know, Lloyd's of London. Something like 40 percent of their business comes out of North America and they've taken a real shellacking in North America. They have simply said, "We are not going to write any more reinsurance on some of these coverages, where we are unable to determine what our losses are going to be." They are insisting they are going to write them in the future on a "claims made" basis instead of an occurrence basis. This has had an enormous impact and has put enormous pressure on the availability of insurance in the open marketplace.

Third, and certainly not the least of the causes, is what I think is the general mismanagement of the business of insurance by the corporate managers of insurance. They certainly have not used good sense in going through this horrendous price-cutting era; nobody could claim that that was good judgment. They find themselves hanging on the ropes, more or less, financially and needing to raise prices and to restrict writings. Apparently they lost sight of the underwriting of their insurance risks on a case-by-case basis; instead, they have looked at their business by the block, which is one of the problems of the people who say that they have had no losses and yet they get canceled or their premiums raised when, in fact, it's the whole block of business that they're looking at.

We certainly don't condone cancellations in midterm. We certainly don't condone abrupt changes in underwriting policies. It seems like the traditional insurance executive has kind of disappeared, and now we have to cope with what I would call the "corporate money manager" type of officer who has got a different viewpoint on the insurance industry.

Senator SASSER. He really doesn't know much about the insurance business?

Mr. NEFF. Yes, that's right. That's exactly right. They are more interested in seeing the bottom line profits than they are in serving

people, which is the way the original people who founded this insurance industry sort of started out.

Senator SASSER. Commissioner, I don't mean to interrupt you here——

Mr. NEFF. Go ahead. Please do.

Senator SASSER. I know that you've got a commitment, and you'll probably run out of time here——

Mr. NEFF. Well, it's important that I get through. I do want to go through this a little bit because there are people who are listening and I want them to hear it, if you don't have any objections.

Senator SASSER. I don't have any objection. I just want to get toward the end of what we might do to solve the problem.

Mr. NEFF. Well, all right, that's what I was just going to get to.

We know why the companies have reacted the way they have. The question is, what are we doing about it? And what can we do about it?

The department has taken a number of actions in this matter. We have set up market assistance pools. We have brought the companies together in a voluntary manner to help cover these people who cannot get coverage. We have talked to the companies directly about how they handle these people, the midterm cancellations, and the cancellation of block business, and we've made great progress.

The problem here in Tennessee is not nearly as bad as it is in other parts of the country.

I also want to comment that the 300-percent to 1,000-percent increases are not standard; they are the exception, Senator. I think it's very misleading to believe that that is, in fact, the standard.

The department is considering legislation on cancellations. We are suggesting that--we are going to put in a bill this year that would not permit an insurance company to cancel midterm except for cause; that is something that we are working on.

But one of the concerns that we have, Senator, quite frankly, is that if we monkey with the system, if we put up barriers or artificial restrictions in Tennessee, the companies will leave the State. No insurance would be the worst of all worlds. There is nothing I can do if a company leaves the State. I had a question asked me at one of the recent meetings I was at: What am I doing about the three companies or so that have already announced they're going to leave the State of Tennessee? There's nothing I can do. I can't go to the pass and stop them; you know, there is nothing I can do to stop a company if he decides to write elsewhere. He can write all the business he wants to; if he wants to write in Texas or Indiana or what have you, he can do it and I can't do anything about it.

I have a real problem with simply doing some quick thing, Senator, such as fixing or freezing prices, such as mandating insurance coverage, such as setting up pools that won't work. That causes me a real problem; I believe that the cure, in that case, would be worse than the disease. I am a firm believe in the open market system. I am a firm believer that what will happen ultimately is that if we let the marketplace solve it—I don't mean leave it alone entirely; see that our people are treated right, do the best we can to smooth this over—but ultimately, the marketplace is actually going to determine what is what. We have had insolvencies; our own Cherokee

Insurance Co. here went belly-up simply because the reinsurance disappeared. Mission Insurance Group just went into conservatorship, which is a major writer of umbrella policies. Employers Mutual of Wausau, the biggest workers' comp company in the country, has just been taken over by Nationwide. And there are all kinds of companies that are in an impaired position or have danger of insolvency. So we need to be very, very careful.

The Insurance Services Office [ISO], thinks they have a solution through the preparation of a new form for claims made. We are holding hearings on that and looking at it. It may be a solution to the availability problem. It worked in the case of medical malpractice. Lawyers, judges—that's on a claims made basis—architects, engineers, claims made is nothing new. They are suggesting that we try for it commercial general liability, not for other items.

I think in the long run there are some actions we can take, Senator. I think, in all honesty, something has to be done about civil justice and the courts system. In the long run, that has got to be something that—and that can be attacked by Washington—but I believe as for the current problem, in my opinion, the States are working toward solutions of it and that the best thing that Washington could probably do is to leave it alone and it will take care of itself.

I'm pleased to have had an opportunity to visit with you on this subject. I would be glad to answer any questions that you might have on this. I have said a lot more in my prepared remarks.

[The prepared statement of Mr. Neff follows:]

Prepared Statement of John C. Neff, Commissioner of the Tennessee Department of Commerce and Insurance

MY NAME IS JOHN C. NEFF AND I AM SPEAKING TODAY AS THE COMMISSIONER OF THE DEPARTMENT OF COMMERCE AND INSURANCE OF THE STATE OF TENNESSEE. THE DEPARTMENT OF COMMERCE AND INSURANCE IS A WIDELY DIVERSIFIED REGULATORY DEPARTMENT OF THE STATE OF TENNESSEE AND OVERSEES BUSINESS REGULATION FOR THOSE INDUSTRIES THAT THE LEGISLATURE HAS FELT SHOULD BE REGULATED FOR THE BENEFIT OF THE PUBLIC. ONE OF OUR MAJOR AREAS IS THAT OF INSURANCE AND THROUGH THE DIVISION OF INSURANCE THE COMMISSIONER IS EMPOWERED BY THE LEGISLATURE TO REGULATE THE BUSINESS OF INSURANCE WITHIN THE STATE OF TENNESSEE.

THE BUSINESS OF INSURANCE IS ONE OF THE VERY FEW MAJOR INDUSTRIES IN THE UNITED STATES THAT IS REGULATED SOLELY BY THE STATES DUE TO THE EXEMPTION IN THE MCCARRAN-FERGUSON ACT. FOR OVER ONE HUNDRED YEARS THE BUSINESS OF INSURANCE HAS BEEN WELL REGULATED BY THE STATES AND OVER THAT PERIOD THE CONSUMER HAS BEEN WELL SERVED. THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC) IS THE OLDEST ACTING COALITION OF STATE OFFICIALS AND ITS VERY EXISTENCE FOR THAT LENGTH OF TIME MUST PROVE THAT IT HAS WORKED WELL.

THE BUSINESS OF INSURANCE IS REGULATED FROM TWO PRIMARY ASPECTS; (1) THE SURVEILLANCE OF THE INSURANCE INDUSTRY FOR SOLVENCY AND (2) THE OVERSIGHT OF THE INDUSTRY FOR MARKET CONDUCT. IN THE CASE OF SOLVENCY SURVEILLANCE, THE NAIC HAS DEVELOPED A VERY SOPHISTICATED STATE OF THE ARTS DATA SYSTEM AND ANALYSIS PROCEDURE FOR IDENTIFYING FINANCIALLY TROUBLED INSURANCE COMPANIES. AN ELABORATE EARLY WARNING SYSTEM IS SET UP THAT REVIEWS ALMOST FIVE THOUSAND UNITED STATES DOMICILED INSURANCE COMPANIES. IN ADDITION, THERE IS A REVIEW OF FOREIGN INSURANCE COMPANIES AND REINSURERS. THERE IS, IN PLACE, AN ELABORATE EXAMINATION SYSTEM THAT PERMITS THE STATES TO JOINTLY EXAMINE ON A REGULAR

BASIS ALL OF THESE INSURANCE COMPANIES. MINIMUM STANDARDS ARE ESTABLISHED AND COMPANIES ARE EXPECTED TO MEET THEM. IN ADDITION, MANY STATES HAVE SET UP GUARANTY FUNDS THAT WILL PROTECT POLICYHOLDERS IN THE EVENT AN INSURANCE COMPANY IS FINANCIALLY INSOLVENT. TENNESSEE HAS A GUARANTY FUND FOR PROPERTY AND CASUALTY COMPANIES BUT NOT FOR LIFE COMPANIES.

THE OVERSIGHT OF INSURANCE COMPANIES FOR MARKET CONDUCT IS AN ONGOING ACTIVITY OF ALL OF THE STATE DEPARTMENTS OF INSURANCE. IT IS IN THIS AREA THAT WE REVIEW THE CLAIM PAYING PROCESSES, CANCELLATIONS, AND OTHER ACTIVITIES OF THE COMPANIES THAT RESULT IN THE PROPER TREATMENT OF CONSUMERS IN OUR STATES. EXAMINATION OF THE COMPANIES ARE ALSO MADE FOR MARKET CONDUCT. IT IS OF GREAT CONCERN TO THE INDIVIDUAL COMMISSIONERS THAT THE CITIZENS IN OUR STATES ARE TREATED PROPERLY AND UNDERSTAND THE TERMS OF THEIR INSURANCE CONTRACTS.

IN ADDITION TO THE TWO MAJOR FUNCTIONS OF AN INSURANCE DEPARTMENT MANY STATES OVERSEE DIRECTLY OR INDIRECTLY THE RATE SETTING MECHANISMS BY THE COMPANIES. SOME STATES HAVE A STRAIGHT OPEN COMPETITION TYPE OF SYSTEM AND DO NOT REGULATE RATES. CALIFORNIA IS A GOOD EXAMPLE OF THIS. OTHER STATES REGULATE RATES IN A VERY HIGHLY STRUCTURED MANNER, SUCH AS IN TEXAS WHICH HAS A LARGE RATE SETTING BUREAU THAT ACTUALLY ESTABLISHES RATES. TENNESSEE HAS A COMBINATION OF THESE SYSTEMS IN THAT WE HAVE A PRIOR APPROVAL REQUIREMENT FOR PERSONAL LINES INSURANCE; i.e., PRIVATE PASSENGER AUTOMOBILE AND HOMEOWNERS. BUT FOR COMMERCIAL PROPERTY AND CASUALTY INSURANCE WE HAVE WHAT IS KNOWN AS A "USE AND FILE" SYSTEM. UNDER THIS LATTER METHOD AN INSURANCE COMPANY MAY GO AHEAD WITH ITS OWN RATES, BUT THEY ARE SUBJECT TO REVIEW BY THE DEPARTMENT AT ANY TIME. IF THE DEPARTMENT DECIDES THAT THE RATES ARE UNFAIR, UNJUST, OR UNFAIRLY DISCRIMINATORY, IT MAY CALL A HEARING

AND REQUIRE THAT EVIDENCE BE SUBMITTED SO THAT IT MAY MAKE A PROPER JUDGEMENT. THERE IS NO RATE REGULATION FOR LIFE INSURANCE COMPANIES IN THE UNITED STATES.

THE PURPOSE OF THIS HEARING IS TO LOOK INTO THE PROBLEM OF AVAILABILITY AND PRICE OF COMMERCIAL PROPERTY AND CASUALTY INSURANCE IN TENNESSEE, PARTICULARLY AS IT AFFECTS SMALL BUSINESSES. WHILE THERE HAVE BEEN SOME MODERATE (IN THE RANGE OF FIVE TO TEN PERCENT) PRICE INCREASES IN THE PERSONAL LINES OF AUTOMOBILE AND HOMEOWNERS INSURANCE WE ARE NOT AWARE OF AN AVAILABILITY PROBLEM. THE STATE FARM INSURANCE GROUP WHICH IS THE LARGEST WRITER IN THE STATE OF TENNESSEE, HAS JUST FILED FOR A 10.7% INCREASE IN AUTOMOBILE RATES AND A 2.7% INCREASE IN HOMEOWNERS RATES. OVER THE LAST FIVE YEARS THE RATE INCREASES HAVE BEEN VERY MODEST AND HAVE NOT EVEN KEPT UP WITH INFLATION. THESE MARKETS ARE HIGHLY COMPETITIVE AND THE PUBLIC IS PROPERLY SERVED. WE HAVE HAD SOME AVAILABILITY PROBLEMS IN THE RURAL AREAS FOR HOMEOWNERS INSURANCE IN AREAS WHERE THERE IS NO FIRE PROTECTION AT ALL. WE BELIEVE THIS PROBLEM HAS BEEN SOLVED.

THE MAIN PROBLEM WE FACE IN TENNESSEE IS AVAILABILITY AND PRICE OF COMMERCIAL PROPERTY AND CASUALTY INSURANCE. THERE IS A REAL PROBLEM, NOT JUST A PERCEIVED PROBLEM. THERE HAS BEEN A SUBSTANTIAL REDUCTION IN AVAILABILITY OF INSURANCE FOR SPECIAL AREAS SUCH AS DAY-CARE CENTERS, TRUCKERS, ROOFERS, LIQUOR DISTRIBUTORS, CONTRACTORS GENERAL LIABILTIY, BUSINESS UMBRELLA POLICIES, ETC. IT IS ALMOST IMPOSSIBLE TO GET OFFICERS AND DIRECTORS LIABILITY INSURANCE OR LARGE UMBRELLA LIABILITY POLICIES. IN ADDITION PRICES HAVE RISEN SUBSTANTIALLY IN THE LAST SIX MONTHS. THIS HAS PUT GREAT PRESSURE ON SMALL BUSINESSES, BOTH IN

ATTEMPTING TO FIND THE INSURANCE AND THEN IN BUDGETING FOR THE SHARP PRICE INCREASES.

WHAT HAS BEEN THE CAUSE OF THIS PROBLEM AND WHY HAS IT SUDDENLY ARISEN? OUR DEPARTMENT HAS SPENT THE LAST SIX MONTHS WORKING ON THIS PROBLEM AS HAS THE NAIC. THERE ARE A NUMBER OF CAUSES OF THE PROBLEM THAT WE SHOULD UNDERSTAND.

FIRST, OVER THE PAST FOUR YEARS THE INSURANCE CARRIERS HAVE PARTICIPATED IN AN ABRUPT PRICE-CUTTING OF ALMOST ALL COMMERCIAL INSURANCE LINES. PREMIUM REDUCTIONS OF 50% WERE COMMON AND REDUCTIONS OF UP TO 80% WERE NOT UNHEARD OF. COMMERCIAL RISK INSURANCE HAS ALWAYS INCLUDED SCHEDULE AND EXPERIENCE RATING PLANS AND DEDUCTIBLE PLANS WHICH REQUIRE JUDGEMENT IN THEIR APPLICATION. THE COMPETITION WAS FIERCE DUE TO THE PHILOSOPHY THAT WITH HIGH INTEREST RATES THE MONEY OBTAINED FROM THE SALE OF INSURANCE THROUGH THE PREMIUMS WOULD BE AVAILABLE FOR INVESTMENT AND COULD HELP OFFSET THE UNDERWRITING LOSSES. DURING THESE FOUR YEARS THE UNDERWRITING LOSSES CONSISTENTLY INCREASED. IN 1984 THE COMBINED LOSS RATIOS FOR THE INDUSTRY WAS APPROXIMATELY 118%. THIS MEANS THAT FOR EVERY DOLLAR OF PREMIUM TAKEN IN, A $1.18 WAS PAID OUT AND NO MATTER HOW YOU LOOK AT IT, IT IS VERY HARD TO MAKE MONEY THAT WAY. AT THE SAME TIME INTEREST RATES THAT ESCALATED TO THE 20% AREA SEVERAL YEARS AGO TURNED DOWNWARD TO APPROXIMATELY THE 10% LEVEL TODAY. THIS OBVIOUSLY AFFECTED INVESTMENT INCOME AND PROVIDED LESS MONEY TO OFFSET THE UNDERWRITING LOSSES WHICH HAD IN TURN ESCALATED UPWARD MORE THAN WAS ESTIMATED. THE COMBINED RESULT IS THAT IN 1984 FOR THE FIRST TIME IN THE HISTORY OF THE INSURANCE BUSINESS, THE COMPANIES SUFFERED AN AGGREGATE DECLINE IN SURPLUS. SINCE THE ABILITY OF AN INSURANCE COMPANY TO SELL INSURANCE IS LIMITED

BY ITS AMOUNT OF SURPLUS (USUALLY THREE TIMES SURPLUS IS REASONABLE FOR TOTAL WRITINGS) THE INSURANCE COMPANIES FOUND THEMSELVES ENTERING 1985 WITH A NEED TO RESTRICT WRITINGS.

SECOND, ONE OF THE MAJOR CAUSES OF THESE INSURANCE COMPANY LOSSES HAS BEEN THE ESCALATING AND IRRATIONAL JUDGEMENTS THAT HAVE BEEN AWARDED THROUGH OUR CIVIL JUSTICE SYSTEM. IT WOULD APPEAR TO US THAT THE COURT SYSTEM IN THE UNITED STATES IS OUT OF HAND AND THAT THESE AWARDS ARE IRRATIONAL AND CERTAINLY IRREGULAR. IT WOULD APPEAR THAT THE COURTS HAVE DECIDED THAT INSURANCE COMPANIES HAVE DEEP POCKETS AND UNLIMITED ASSETS AND THEREFORE THE COURTS ARE PERFECTLY WILLING TO ASSIGN TO AN INJURED PARTY ENORMOUS AWARDS INCLUDING PUNITIVE DAMAGES. THIS HAS RESULTED IN AN INABILITY OF INSURANCE COMPANIES TO PREDICT THEIR POTENTIAL LOSSES. THEY ARE NOW UNWILLING TO INSURE A RISK WHERE THE POTENTIAL LOSS ON DOWN THE LINE COULD BE INFINITE IN SIZE. IT IS ONE THING TO INSURE A HOUSE THAT BURNS DOWN WHEN WE ALL CAN PRETTY WELL ESTIMATE THE COST OF THE HOUSE, BUT IS IS ANOTHER THING TO ESTIMATE THE COST OF UNDERGROUND SEEPAGE FROM A LANDFILL INTO A WATER SYSTEM WHEN THE COURT DECIDES THAT EACH SIP OF WATER IS AN INSURABLE INCIDENT. SOMEWHERE, SOMEHOW, ALONG THE LINE, SOMETHING NEEDS TO BE DONE ABOUT THE CIVIL JUSTICE SYSTEM IF WE ARE GOING TO SEE A STABILIZED INSURANCE MARKETPLACE.

AS YOU UNDOUBTEDLY KNOW, MOST COMMERCIAL PROPERTY AND CASUALTY BUSINESS FINDS IT'S WAY INTO THE REINSURANCE MARKETPLACE. ALMOST ALL CARRIERS WILL TAKE A PRIMARY RISK AND REINSURE IT WITH OTHER CARRIERS. A CONTRACTOR IN TENNESSEE WHO MIGHT PURCHASE A $25,000,000 UMBRELLA FROM A CARRIER WOULD UNDOUBTEDLY HAVE THAT RISK PARTITIONED AMONG MANY REINSURERS AND THE REINSURANCE MARKET IS WORLDWIDE. THE BEST KNOWN

ORGANIZATION OF REINSURERS IS LLOYD'S OF LONDON, AND IN THE PAST FEW YEARS LLOYD'S HAS REPORTED THAT IT HAS TAKEN VERY SUBSTANTIAL LOSSES IN ITS NORTH AMERICAN INSURANCE BUSINESS DUE PRIMARILY TO THE CIVIL JUSTICE SYSTEM AND THE UNCERTAINTY OF THE JUDGMENTS. AS A RESULT, LLOYD'S HAS TOLD THE AMERICAN MARKETPLACE THAT IT IS IN FACT GOING TO REDUCE ITS REINSURANCE WRITINGS AND IS ONLY GOING TO REINSURE BUSINESS IN THE FUTURE WRITTEN ON A CLAIMS MADE BASIS RATHER THAN AN OCCURRENCE BASIS, AS HAS BEEN THE HISTORIC CASE. THIS HAS ALSO PUT PRESSURE ON THE AVAILABILITY OF INSURANCE IN THE LOCAL MARKETPLACE.

THIRD, AND CERTAINLY NOT THE LEAST IS WHAT I WOULD TERM THE GENERAL MISMANAGEMENT OF THE BUSINESS OF INSURANCE BY THE CORPORATE MANAGERS OF COMPANIES. CERTAINLY THEY HAVE NOT USED GOOD SENSE IN GOING THROUGH A HORRENDOUS PRICE-CUTTING ERA ONLY TO FIND THEMSELVES HANGING ON THE ROPE FINANCIALLY AND THUS NEEDING TO RAISE PRICES AND TO RESTRICT WRITINGS. APPARENTLY THEY LOST SIGHT OF UNDERWRITING THEIR INSURANCE RISKS ON A CASE BY CASE BASIS. PARTICULARLY RESENTED BY BOTH THE DEPARTMENT AND THE INSUREDS IN TENNESSEE IS THE DISMAL WAY IN WHICH THEY TREATED THEIR CLIENTS. CANCELLATIONS IN MIDTERM AND ABRUPT CHANGES IN UNDERWRITING POLICIES HAVE DEVASTATED THE MARKETPLACE AND LEFT SOME BUSINESSES ALMOST UNABLE TO COPE WITH THE PROBLEM. IT WOULD APPEAR THAT MANAGERS OF INSURANCE COMPANIES HAVE CHANGED FROM THE TRADITIONAL INSURANCE EXECUTIVE TO CORPORATE FINANCIAL MONEY MANAGERS WHO ARE MORE INTERESTED IN BOTTOM LINE PROFITS THAN IN SERVING PEOPLE. THERE HAS BEEN A COMPLETE FAILURE BY BOTH COMPANIES AND AGENTS IN EXPLAINING THE SITUATION TO THE BUYING PUBLIC.

THE COMPANIES' REACTIONS TO THE ABOVE LISTED PROBLEMS SHOULD NOT BE SURPRISING. IT WOULD BE NATURAL TO EXPECT THEM TO RAISE PRICES WHEN THEY FINALLY REALIZED HOW MUCH MONEY THER WERE LOSING AND IF THEY CONTINUED THE TRACK THEY WERE ON THEY WOULD SOON BE INSOLVENT. IT IS

ALSO UNDERSTANDABLE WHY THEY WOULD RESTRICT THEIR WRITINGS AND WHY THEY WOULD CUT BACK ON HIGHER RISK LINES. THOSE LINES WHICH HAVE BEEN MOST SUBJECT TO LITIGATION OR STATE OF THE ART CHANGES OR THAT HAVE THE LONGEST POTENTIAL TAIL ARE OBVIOUSLY THE ONES THAT GET CUT BACK. POLLUTION AND ENVIRONMENTAL LIABILITIES TODAY POSE ENORMOUS FUTURE RISKS AND THEREFORE INSURANCE IS ALMOST IMPOSSIBLE TO BUY. DAY-CARE CENTERS HAVE RUN INTO THE PROBLEM OF CHILD MOLESTATION AND THE PUBLICITY GENERATED HAS FOCUSED THE ATTENTION OF INSURERS ON THIS LINE. CERTAINLY ANYONE INVOLVED WITH ASBESTOS HAS LEARNED HOW IMPOSSIBLE IT HAS BEEN TO INSURE THAT TYPE OF BUSINESS. I DO NOT MEAN TO CONDONE THE ACTIONS OF THESE INSURANCE COMPANIES, AND I CAN UNDERSTAND WHY THEY TOOK SOME OF THE ACTIONS, BUT I DO OBJECT TO HOW THEY TREATED THE INSUREDS.

A LOGICAL QUESTION IS WHY THE COMPANIES WERE PERMITTED TO GET INTO SUCH A POOR UNDERWRITING POSITION. IT IS DIFFICULT, IF NOT IMPOSSIBLE, FOR A COMMISSIONER TO NOT PERMIT RATE REDUCTIONS AND RATING PLANS WHICH PRODUCE LOWER PREMIUMS FOR THE POLICYHOLDER. SINCE THE INSURANCE INDUSTRY HAS VERY LITTLE CREDIBILITY WITH THE PUBLIC, I FEEL IT WOULD BE AN UNTENABLE POSITION TO DENY REDUCTIONS IN ORDER TO PROTECT THE INSURANCE COMPANIES.

THE DEPARTMENT OF COMMERCE AND INSURANCE IN TENNESSEE HAS TAKEN A NUMBER OF ACTIONS IN REGARD TO THIS MATTER. WE HAVE HELPED TO SET UP MARKET ASSISTANCE PROGRAMS BEST TYPIFIED BY OUR INFORMAL PROGRAM TO HELP THE CLASS 10 INSUREDS IN THE RURAL AREAS. THROUGH THE DEPARTMENT AND OTHERS, THE COMPANIES WERE PERSUADED TO BAND TOGETHER TO HANDLE THESE INDIVIDUAL PROBLEMS AND, TO THE BEST OF MY KNOWLEDGE, IT IS WORKING WELL.

WE HAVE SPENT A GREAT DEAL OF TIME ON INDIVIDUAL COMPANIES TRYING TO PERSUADE THEM TO ACT IN A STATESMANLIKE MANNER WITH RESPECT TO THE PROBLEMS OF PRICE INCREASES AND RESTRICTED WRITINGS. WE HAVE BEEN PARTICULARLY INCENSED WITH MIDTERM CANCELLATIONS AND HAVE BEEN SUCCESSFUL IN A NUMBER OF CASES IN GETTING COMPANIES TO ABANDON THAT PRACTICE. IT HAS BEEN MUCH WORSE IN OTHER AREAS OF THE UNITED STATES THAN IT HAS BEEN IN TENNESSEE. WE WILL CONTINUE TO FIGHT ABUSES BY THE INSURANCE COMPANIES AND TO REPRESENT THE CONSUMERS IN TENNESSEE WITH THEIR PROBLEMS.

THE DEPARTMENT IS CONSIDERING SOME LEGISLATION IN THE AREA OF CANCELLATION OF INSURANCE BY COMPANIES IN THE MIDDLE OF THE TERM. WE FEEL THIS IS A VERY UNFAIR PRACTICE AND WHILE WE HAVE CONSUMER PROTECTION LAWS IN TENNESSEE, WE WOULD LIKE TO BE MORE SPECIFIC IN THIS PARTICULAR AREA. WE FEEL IF AN INSURED PURCHASES INSURANCE FROM A COMPANY AFTER SEARCHING AROUND, HE IS ENTITLED TO HAVE THAT INSURANCE FOR THE PERIOD COVERED BY THE TERM OF THE CONTRACT. IF AN INSURED CANCELS, THE INSURED IS SHORT RATED AND PENALIZED, BUT IF THE COMPANY CANCELS, UNDER THE PRESENT CONDITIONS OF TEN TO THIRTY DAYS NOTICE, THERE IS NO PENALTY FOR THE COMPANY. WE HAVE FOUND TIME AND TIME AGAIN RECENTLY THAT WHEN A COMPANY GIVES THIRTY DAY NOTICES TO A SMALL BUSINESS, THAT BUSINESS IS UNABLE TO GET AN ADEQUATE QUOTE WITHIN THE THIRTY DAY PERIOD LEAVING THE INSURED HANGING. OUR PROPOSAL WILL BE THAT INSURANCE COMPANIES CANNOT CANEL DURING THE TERM OF THE CONTRACT WITHOUT CAUSE, AND THAT IF THE INSURANCE COMPANY IS NOT GOING TO RENEW THE POLICY OR IS GOING TO INCREASE PRICES FOR THAT COVERAGE IN EXCESS OF 25%, THEN THE INSURED WILL BE GIVEN SIXTY DAYS NOTICE. "CAUSE" IN THIS CASE WOULD BE SUCH THINGS AS NONPAYMENT OF PREMIUM, INCORRECT INFORMATION ON THE APPLICATION, CHANGES OF BUSINESS OR RISKS, ETC.

ONE OF THE REAL CONCERNS OF THE DEPARTMENT OF COMMERCE AND INSURANCE IS THAT COMPANIES WILL LEAVE THE STATE OF TENNESSEE AND NOT OFFER INSURANCE AT ALL. WE ARE ALREADY HAVING COMPANIES LEAVE THE STATE, AND I HAVE BEEN ASKED WHAT AM I GOING TO DO ABOUT IT. THERE IS REALLY NOTHING I CAN DO IF A COMPANY DECIDES TO STOP WRITING INSURANCE IN TENNESSEE AND GOES ELSEWHERE. THEY CAN NOW WRITE MORE BUSINESS THAN THEY KNOW WHAT TO DO WITH, AND TENNESSEE REPRESENTS ONLY 2% OF THE POPULATION. TENNESSEE, AS MARKETPLACE FOR INSURANCE, IS GENERALLY CHEAPER THAN ELSEWHERE. WE ARE CONCERNED THAT IF WE PUT ON UNREASONABLE LIMITATIONS OR ACT IN AN UNREASONABLE MANNER, OUR INSUREDS WILL BE UNABLE TO BUY INSURANCE AT ANY PRICE. SUGGESTIONS SUCH AS PRICE FREEZING AND MANDATORY WRITINGS ARE VERY UNLIKELY TO WORK AND WILL BE MORE LIKELY TO CHASE INSURERS OUT OF TENNESSEE.

AT THE PRESENT TIME, AUTOMOBILE AND WORKERS COMPENSATION ARE THE ONLY LINES FOR WHICH A POOL IS AVAILABLE TO PROVIDE COVERAGE. BECAUSE OF THE ESSENTIAL NATURE OF AUTOMOBILE INSURANCE, THE TENNESSEE LEGISLATURE ENACTED LAWS REQUIRING AN ASSIGNED RISK POOL IN 1949. ADDITIONALLY, TENNESSEE LAW REQUIRES EMPLOYERS WITH FIVE (5) OR MORE EMPLOYEES TO HAVE WORKERS COMPENSATION INSURANCE. TO ESTABLISH ANY OTHER POOLS WOULD REQUIRE LEGISLATION.

MANY OF THE LARGE INCREASES OF SEVERAL HUNDRED PERCENT RESULT WHEN A COMPANY DECIDES TO STOP WRITING A PARTICULAR LINE OF BUSINESS. SURPLUS LINES COMPANIES ARE PERMITTED BY LAW TO OPERATE FOR THE HARD TO PLACE RISK WITHOUT RATE AND FORM REGULATION. A CHILD CARE RISK, FOR EXAMPLE, BECAUSE OF THE PUBLICITY OF SOME CASES AND A GENERAL DEPRESSED RATE LEVEL, NOW HAVE A LIMITED MARKET IN ADMITTED CARRIERS AND MUST FIND COVERAGE IN THE SURPLUS LINES MARKET. MOST LINES OF INSURANCE

HAVE COMPANIES WHICH WRITE NONSTANDARD OR REJECTED RISKS AT HIGHER THAN AVERAGE RATES EVEN WHEN THE MARKET IS SOFT. WHEN THE MARKET BEGINS TO CORRECT ITSELF, BORDERLINE RISKS MAY BECOME UNACCEPTABLE AT STANDARD RATES AND MUST PURCHASE COVERAGE IN A NONSTANDARD PROGRAM AND THE RESULTING PERCENTAGE INCREASE CAN BE STAGGERING.

IN ADDITION, WE MUST CONCERN OURSELVES WITH THE SOLVENCY OF THESE INSURANCE COMPANIES AND OVER THE LAST FEW YEARS AN INCREASING NUMBER OF COMPANIES HAVE APPEARED ON THE EARLY WARNING LIST OF THE NAIC. WE HAVE HAD A NUMBER OF FINANCIAL FAILURES AND COMPANIES IN SEVERE FINANCIAL DIFFICULTIES. OUR OWN CHEROKEE INSURANCE COMPANY IN TENNESSEE WENT INTO RECEIVERSHIP LAST YEAR BECAUSE REINSURERS BECAME INSOLVENT. THE MISSION INSURANCE COMPANY, WHICH IS A LARGE WRITER OF UMBRELLA POLICIES IN TENNESSEE, HAS JUST BEEN PLACED IN THE HANDS OF A CONSERVATOR. THE EMPLOYERS OF WAUSAU, WHICH IS ONE OF THE LARGEST WRITERS IN AMERICA OF WORKER'S COMPENSATION, HAS BEEN IN SEVERE FINANCIAL DIFFICULTY AND HAS NOW BEEN TAKEN OVER BY THE NATIONWIDE GROUP.

INDUSTRY HAS ATTEMPTED TO ANSWER THIS AVAILABILITY PROBLEM BY PREPARING THROUGH THE INSURANCE SERVICES OFFICE A NEW POLICY FORM WHEREIN MOST COMMERCIAL GENERAL LIABILITY INSURANCE COVERAGES WOULD BE WRITTEN ON A "CLAIMS MADE" BASIS RATHER THAN THE TRADITIONAL OCCURRENCE BASIS. WHILE THIS IS A HIGHLY TECHNICAL AND COMPLICATED CONCEPT, IT IS ONE THAT IS CURRENTLY UNDER CONSIDERATION BY ALL OF THE STATES. TO OVER SIMPLIFY SOMEWHAT, UNDER THE PRESENT SYSTEM AN OCCURRENCE POLICY MEANS THAT A CLAIM WHEN FILED IS COVERED BY THE POLICY THAT WAS IN EFFECT AT THE TIME THE INCIDENT OCCURRED. A "CLAIMS MADE" POLICY MEANS THAT THE POLICY THAT IS IN EFFECT AT THE TIME THE CLAIM

IS FILED IS THE ONE THAT WOULD COVER THE PARTICULAR CLAIM. TO ILLUSTRATE, IF A DRUG MANUFACTURLR DISTRIBUTED A BATCH OF DRUGS THAT LATER TURNED OUT TO CAUSE SOME SERIOUS INJURY, UNDER AN OCCURRENCE POLICY THE CLAIM WOULD BE PAID BY THE POLICY THAT WAS IN FORCE AT THE TIME THE BATCH OF DRUGS WAS MADE, WHICH MAY HAVE BEEN MANY, MANY, YEARS EARLIER. UNDER A "CLAIMS MADE" POLICY, THE CLAIM WOULD BE PAID BY THE POLICY IN FORCE AT THE TIME THE CLAIM WAS DISCOVERED AND FILED. THE ATTEMPT HERE IS TO DESIGN A POLICY WHERE THE CLAIMS ARE MORE IN LINE AND CURRENT WITH PREMIUMS BEING PAID. THE ASBESTOS PROBLEM IS AN ILLUSTRATION OF CLAIMS BEING MADE AND JUDGED UNDER TODAY'S STANDARD OF COURT DECISIONS AND ENVIRONMENTAL POLICY. THE PREMIUMS WERE COLLECTED AS LONG AGO AS TWENTY YEARS WHEN THERE WAS NO SUCH THING AS AN ASBESTOS PROBLEM. HOPEFULLY THIS NEW CLAIMS MADE FORM, IF APPROVED BY ALL THE STATES, AND IF PUT INTO EFFECT, MAY BE A MAJOR SOLUTION TO THE AVAILABILITY PROBLEM. IT DID HELP IN THE CASE OF MEDICAL MALPRACTICE INSURANCE AND OTHER PROFESSIONAL LIABILITY INSURANCE COVERAGE SUCH AS LAWYERS AND ARCHITECTS. THOSE POLICIES, WHICH WERE ORIGINALLY ON AN OCCURRENCE BASIS, HAVE BEEN WRITTEN FOR MANY YEARS ON A CLAIMS MADE BASIS, AND WHEN THAT HAPPENED THE AVAILABILITY OF THIS PRODUCT SUBSTANTIALLY INCREASED.

IT IS MY PERSONAL OPINION THAT IN THE SHORT RUN, THIS AVAILABILITY AND PRICE PROBLEM WILL BE SOLVED BY THE MARKETPLACE, AS MOST PROBLEMS ARE SOLVED. IT IS THE FUNCTION AND THE DUTY OF THE DEPARTMENT TO ASSIST THE MARKET IN BEING ORDERLY AND FAIR, HOWEVER WE DO NOT BELIEVE THAT WE CAN CHANGE FUNDAMENTAL ECONOMIC FORCES THAT EXIST TODAY. IT MAY BE PAINFUL AND TAKE LONGER THAN WE WISH, BUT AS INSURERS ADJUST PREMIUMS THEY WILL GET MORE COMPETITIVE. REINSURERS WILL COME BACK INTO

THE MARKETPLACE, PARTICULARLY IF SOME ADJUSTMENT IS MADE IN THE CIVIL JUSTICE SYSTEM. THE INSURERS THEMSELVES WILL DO A CONSIDERABLE AMOUNT OF ADJUSTING IN SUCH AREAS AS TOTAL COVERAGE, DEDUCTIBLES, AND LOSS PREVENTION PROGRAMS. PROBABLY THE WORST THING WE CAN DO IS INTERFERE WITH THE NORMAL WORKINGS OF THE MARKETPLACE. WE MIGHT LOOK BACK ON OUR EXPERIENCE WITH GASOLINE A NUMBER OF YEARS AGO. WHEN THE PRICE WAS FROZEN WE ALL STOOD IN LINES, BUT IT TURNED OUT THAT THE REAL SOLUTION WAS TO LET THE MARKETPLACE REACT IN A NORMAL MANNER AND WE SHORTLY HAD MORE GASOLINE THAN WE KNEW WHAT TO DO WITH AND HAD CARS THAT USED A CONSIDERABLE AMOUNT LESS PER MILE.

IN THE LONG RUN, WE MUST TAKE OTHER STEPS TO ASSURE AN ORDERLY MARKET FOR THE PUBLIC. WE NEED CORRECTIONS IN THE CIVIL JUSTICE SYSTEM AND STABLE, SENSIBLE UNDERWRITING PRACTICES BY INSURERS. WE NEED TO IMPROVE OUR DATA GATHERING AND SOLVENCY SURVEILLANCE. WE ALSO NEED TO REGULATE IN SOME MANNER THE ACTIONS OF REINSURERS AND SURPLUS MARKET WRITERS. ABOVE ALL, WE NEED BETTER MANAGEMENT.

I AM VERY PLEASED TO HAVE HAD AN OPPORTUNITY TO PARTICIPATE IN THIS HEARING AND LOOK FORWARD TO WORKING WITH THE SENATE COMMITTEE ON SMALL BUSINESS ON THIS MATTER SHOULD THEY FIND THAT DESIREABLE.

THANK YOU.

Senator SASSER. Well, let me say, Commissioner, that your entire statement will be made a part of the hearing record. I have read it, and it sets out the problem, I think, very well.

Commissioner, we are both faced with complaints coming from individual businesses around the State. Now, you indicated a moment ago that perhaps we were overstating the case with regard to rate increases. Let me just cite you some items that have come into our office.

The Rail Petroleum Co. in Galveston, TN, which employs 10 or 12 persons, had insurance costs of over $9,000 last year. Their premiums were increased to $28,500 this year.

Leader Federal Savings & Loan, Memphis, TN, one of the leading S&L's in the State, one that I have always thought to be very well managed, had a 350-percent increase in coverage for their directors' and officers' liability——

Mr. NEFF. They're one of the few people that I've heard of that can get it.

Senator SASSER. Here in Nashville, the Oakley Lumber Co. saw their premium increased from $13,000 last year to $31,000 this year.

Premiums from the J.L. Haney Co. of Cleveland, TN, a construction firm, went from $30,000 last year to $72,000 this year.

So that is the magnitude of the problem that we're facing, and I know you're well aware of that.

Now——

Mr. NEFF. Senator, if I may interrupt to say to you, that's four examples. There are 4½ million people in Tennessee. I'm only trying to suggest to you that you always hear from those who have the greatest swings. I think that we all have to understand that. What I am saying to you is that I do not believe those represent the entire marketplace with that kind of breadth.

Now, what happened—and I think it's important to understand this—the posted rates, for example, let's say, are $100. When they are reduced to $40 and then turn around and go back up to $100 or $110, you have a 300-percent increase from the $40. That's the kind of thing that's happened. And yet, those rates are just approaching where they were in the 1979–80 era. And that's the kind of a problem that we have.

Senator SASSER. Well, you said earlier that the problem was not just a problem here in the State, that it was a national problem; indeed, it is an international problem, according to your testimony. And I have difficulty in seeing how State governments are going to be able to deal with a problem that is national, or indeed international, in scope.

Now, I alluded earlier to a "boom-or-bust" theory in the insurance market, and I think you said something about it yourself. In that situation insurance companies cut premiums but survived on additional investment income. Now, should we be searching for some approach to do away with this boom-or-bust, these dramatic ups and downs, in the insurance industry. Should we move to make the entire market more stable?

Mr. NEFF. Senator, I have never—I have been in business a long time, in all kinds of miscellaneous businesses—I have never known whether any government or body is able to judge business so well

as to hold it on a level basis. Nothing works as well as the free enterprise, open market system. Sure, you can go through those things, but in the long run that is far and away the most efficient system. The difficulties you have in trying to arrive at rates is something the States have struggled with for years, and most of us have found that it is not a science; at best, it's an art. It's almost impossible, and to try to do it on a national basis would be almost—it would be a mammoth job.

The State system has worked well. We're here at a hearing, Senator, because something has happened in the last 6 months. This insurance business has been around for a long period of time; when's the last time we had a hearing of this type? The last real problem area was about 1973 or 1974 with medical malpractice. That problem was solved, for the most part; medical malpractice insurance became available and became competitive again. But there have been relatively few of these kinds of periods, and for us to jump up because we are in a serious problem now and say, "The system isn't any good and doesn't work; we'd better think of another one; we'd better try another way," is, in my opinion, the wrong approach. The fundamental problem that we're having here is the need for court reform and court system with these awards that must be charged, must be paid for. Until somebody solves that problem, Senator, we're going to get these swings.

When you have an asbestos risk, for example—there was an award in California, $14.5 million on the asbestos risk, applied against a policy written 14 years ago; the premium for the policy was $78. Now, how in the world is anybody going to write a policy that is going to be settled 18 years later under an entirely different social system, entirely different justice system, a different inflationary system, and all of that kind of thing, when you have those kinds of court orders?

Now, if Washington wants to attack the problem, in my opinion this is the direction to go. Give them an atmosphere and an environment in which the insurance companies can make intelligent actuarial underwriting decisions. Sure, there'll be competition, and sure, there'll be cycles; there are cycles in everything. Around here we're talking about the automobile business; there are certainly cycles in the automobile business. Or the gasoline business, or you name it.

Senator SASSER. Well, Commissioner, I don't think that anyone would want to totally redo the insurance system. I think it has stood the Western World in good stead for well over 200 years. You have indicated, in your testimony here today and in other forums, that we should let the market take care of this situation.

Now, the question that some of us have is, how long should we ask small business owners and others to wait for the market corrections? How long does it normally take for the market to correct itself? Should we do anything for those companies, small companies, which can no longer afford insurance during this period of market correction? Should we do anything about those lines of insurance which may virtually disappear as the market corrects itself?

Those are questions that I think need to be answered, even if it's on an interim approach until such time as the market does right

itself and correct what I think everyone concedes—and you concede in your testimony today—is a very difficult problem.

Mr. NEFF. Well, Senator, I don't know how long it's going to take for the system to work. I think if we interfere with it—I'll tell you quite frankly—I think if we interfere with it, it will take longer.

I don't know of any interim kind of approach. Should we get into fixing or freezing prices? If you mean freeze them on a nationwide basis, the insurance will disappear. If you talk about freezing it in one State, it will disappear in Tennessee and won't disappear in Kentucky. I don't know. And we've examined it and thought about some of these approaches, Senator. If you mandate insurance through some kind of an assigned risk pool or something, they are going to be very difficult to handle. We have one for the automobile business; it works well in Tennessee and it doesn't work well in some other States. A very, very difficult problem.

I don't know of a solution, a stopgap, a quick fix that is going to make insurance available. There will be some adjustments by small businesses. They'll have larger deductibles, carry less insurance, they will pay more for a while. I honestly believe it will, in fact, work out. I believe we have to work with the insurance companies, and I believe we have to set up market system plans. I believe that we have to see that these companies do not abuse customers. I believe that.

Senator SASSER. Well, Commissioner, what is underway here at the State level, under the auspices of your Department, to deal with this situation?

Mr. NEFF. Well, as I told you, we have set up assistance plans; resolved, I think, to a large extent, the class 10 insurance problem, where we had insurance pretty much disappear, supposedly, from the class 10 area which is the uninsured areas out there without any fire service; we certainly helped the truckers get their insurance when they were having a difficult time doing it. And we've attacked one of these after another. We've helped day-care centers; we've helped a lot of them get insurance. We've advertised across the State for people to call us, and those who have—and there have been surprising few, Senator, but there are still 4½ million people in this State—and I think the State is pursuing the proper things it should do, including looking at this new claims form, this claims made form, which, we hope, if properly structured and approved in the various States. We think it will greatly assist the availability problem. It has worked in the past; we believe it will again.

So we think we are doing all of the proper things, and we think the improper things are freezing prices and mandating insurance coverages and that kind of thing.

Senator SASSER. Commissioner, Florida is looking into the formation of assigned risk pools for various lines of insurance. Are we doing that here in the State of Tennessee?

Mr. NEFF. We have looked into it. We're a lot smaller State than Florida, and one of the things when you get into an assigned risk pool, you have to look at the number of people in the market for that particular coverage. We have, of course, assigned risk for automobiles; it has a very broad market, as you know, with everybody in the State in it. And you know how an assigned risk pool market works, generally speaking. You take the risks of people who can't

get insurance and spread it on all the people who are writing that line. But when you get into something like day-care centers, for instance, where you don't have a whole lot of day-care centers in the State and you don't have a whole lot of underwriters—you've only got two or three companies writing in the State—you start an assigned risk pool like that, those writers will leave the State.

Now, if what you're going to suggest that is that the people who are writing automobile and homeowners should also write day-care centers, why, that gets to be a problem.

The specific answer to your question is yes, the State has looked into it. And Florida didn't say they're passing it; they only said they're looking into it.

Senator SASSER. The Insurance Commissioners in Oregon and Kansas are threatening to issue permanent orders restricting mid-term cancellations. Do we have a problem with that in Tennessee, and how are we dealing with it?

Mr. NEFF. Senator, we haven't had a real serious problem. We have had some of it, and that's what I said when I said that we are proposing legislation this year—I've proposed it to the Governor already for his backing—that will, in fact, prohibit mid-term cancellations. In fact, it goes a step further than that, Senator. Our proposed legislation says that if a company—not only can it not cancel, except for cause, a policy; once it's written, it's written—but that if it's not going to renew or if it's going to increase its premium by more than 25 percent, it would have to give the customer 60 days' notice.

One of our problems is the cancellation notice, which is 30 days, and the inability to get a quote within 60, leaving people hanging on the ropes. We've solved those on a case-by-case basis; but the answer is yes, we're considering that, and actually are proposing it to the Governor. Whether the Governor will accept it or not hasn't been decided; he's still working on his programs.

Senator SASSER. Well, Commissioner, I don't want to keep you here unduly, and I know you've got another commitment. We appreciate very much your appearing here today and giving us the benefit of your views. It's been very helpful.

Mr. NEFF. Thank you.

Senator SASSER. Thank you.

Our next witnesses will consist of a panel. Mr. J.D. Stephens, the director of the Holly Tree Day-Care Center in Franklin, TN; Mr. William Hackett, the executive director of the Community Day Care and Comprehensive Social Services Association of Memphis, TN; and Ms. Evelyn Boshers, president of the Association of Family Group and Day-Care Homes in Nashville, TN. Is Ms. Boshers here?

I will welcome the three of you here today and say that we appreciate very much your appearing and giving us the benefit of your views. And Mr. Stephens, since you appear first on the list, we'll start out with you and get your observations.

STATEMENT OF J. D. STEPHENS, DIRECTOR, HOLLY TREE DAY-CARE CENTER, FRANKLIN, TN

Mr. STEPHENS. My name is J.D. Stephens. To give you a little bit of data, my wife and I own four child care centers in the middle Tennessee area. We care for approximately 250 children.

In 1984, we had a liability insurance premium of $3,000. When we went to renew in 1985 with St. Paul's, who we have the coverage with, they refused to renew our insurance even though we had had no claims with them. After much searching we located one insurance company through CIGNA for 1985, and our premium went up to $9,000. This is a 300-percent increase.

Senator SASSER. So when we say there are premium increases of 300 percent or up to 1,000 percent, we're not exaggerating on the 300 percent, are we?

Mr. STEPHENS. Not as far as day care is concerned, no.

One problem that we are starting to face is that CIGNA has already started developing very strict regulations and standards, and we have a very strong fear that for 1986 the insurance premium—we may not be able to renew because of the very strict standards. We've heard quite a bit about that.

Our main concern—one of our main concerns is the smaller child care centers. We fortunately had enough children in our centers that we could pass on the cost through a modest price increase to our parents, and it didn't affect us that much; but we are very concerned about the small centers. When I say the small centers, I'm talking about 25 children or less, and in homes, we're talking about 12 children or less. So we're very concerned about those, especially in the middle Tennessee area. The last estimate we had obtained was that, with respect to before 1990, there is going to be needed an additional 10,000 child care spaces in this area. And we are worried considerably that the smaller centers are going to have to go out of business. We desperately need every center we can get in the middle Tennessee area.

Most of our colleagues feel like the insurance companies, especially in the child care business, are overreacting to the sexual abuse headlines. Everything we've read on it indicates that insurance companies are not basing their increases on any historical data whatsoever; in fact, most of them have taken out coverage of the insurance if there's any sexual abuse, so we're not covered basically for that anyway. And so we just kind of feel that the insurance companies are overreacting to the headlines that have been presented to them.

We've thought of several possibilities; some of them, the Commissioner had talked about. We've talked about establishing risk pools and that type of thing, but as he mentioned, that's not very easily done as far as day-care centers are concerned. I feel like what we need to do—this is just a couple of suggestions, but I feel like the day-care centers in the State are going to have to start regulating themselves very carefully as far as accident hazards and anything that would cause a problem as far as needing liability insurance.

Another proposal that I have is that I would like to see—and it's not effective at this point—I would like to see that an accident insurance policy be required for all children in day-care centers——

Senator SASSER. Paid for by the parents?

Mr. STEPHENS. Paid for by the parents, obviously, but something along that line; but it has been proven that if you can cover the medical expenses, you reduce the possibility of losses. So I'm very strongly encouraging that as far as all day-care centers are concerned.

The second part I would like to mention is the fact that I would like for the insurance companies to gain some historical data on the centers before they cancel their policies, before they refuse to renew them. We do not feel like it's fair to the day-care centers as a whole just to go across the board and say, "We're no longer going to insure day-care centers," which is what's happening in the industry. So we feel like we would like for the insurance companies to take each center or each situation separately and judge that center on what kind of safety regulations they have, how well they are observing the regulations that are enforced by the State, and even develop some of their own, if need be. But it would help us tremendously if the insurance companies will do that, not only for the fact that it would give us insurance; it would also help us in the fact that when you have a poor child care center, that you would have the benefit of saying, "You either have to shape up or you will not have insurance."

We would like to have the insurance companies stop going across the board and saying, "We will not insure any more child care centers," but instead, going strictly by the past claims record of that center.

We feel like the regulations are very fair, as far as what the State has imposed on the day-care centers in Tennessee, and it would be a lot easier if we could regulate our own centers and let the State regulate them as opposed to letting the insurance companies tell us what the regulations are going to be for insurability.

[The prepared statement of Mr. Stephens follows:]

Prepared Statement of J.D. Stephens, Director, Holly Tree Day-Care Center, Franklin, TN

THE EFFECTS OF INSURANCE ON CHILD CARE PROVIDERS

My name is J.D. Stephens. My wife and I own and operate four child care centers in Middle Tennessee. We also own a child care consulting firm assisting development of new programs and improvement of existing programs.

During 1984, we were caring for approximately 250 children with an annual insurance cost of $3000.00. St. Paul refused to renew our policy even though we had not experienced any claims with the company. After much searching, we located insurance through CIGNA for the 1985 year at a premium cost of $9000.00 or 300% increase. Now CIGNA is developing standards too rigid for most centers to meet before issuing coverage and we are uncertain as to the possibility of future coverage.

Our main concern is for the smaller child care centers and homes who either cannot obtain insurance coverage or cannot afford to pass the increased cost to the clients without undue burden on the working parents. With 50% of pre-school children's mothers now working we need these centers. The Tennessee licensing agency predicts that in Nashville alone the need for child care spaces will grow by approximately 10,000 children by 1990.

I feel insurance companies are reacting to child abuse headlines and not relying on historical data to justify these increases. In the June 10, 1985 issue of Business Insurance it is stated "Insurance companies can't justify their actions based on the claims data that's available...There's no question that they have very little historic data on instances of child abuse or settlements of child abuse claims originating from day care centers... Decisions are being made on the basis of concern over publicity rather than on anything actuarial."

Some possible solutions for centers who have been unable to secure coverage would be:

1. A captive insurance arrangement in which insurance companies are required to write policies for these centers
2. The State could establish assigned risk pools to cover child care centers.

However, there are disadvantages to these as well and they should be considered as short term arrangements only.

For centers who have insurance presently, improvements must still be made. First, the day care industry can help by monitoring their own programs through elimination of potential safety problems and compliance with safety regulations. Also an accident policy should be required as it has been proven that parents are dissuaded from suing if medical bills are covered by the center or its insurance policy.

Second, I feel the insurance industry should develop methods to determine which programs are complying with appropriate regulations. This could be done easily by monitoring violations reported to the state regulatory agencies and combining those with historical claim data of that center prior to providing coverage. This would be a better plan than just getting completely out of the child care insurance business or charging exhorbatant rates to everyone. This would also assist the child care industry as poor quality centers would have to shape up or face lack of insurability.

In most states, child care regulations are fair and reasonable. If the insurance companies could make sure these regulations are being met, there would be no need to add further regulations that would drive more centers out of business because they could not afford to comply.

SPECIAL REPORTS
DAY CARE INFORMATION SERVICE'S IN-DEPTH REPORT ON TIMELY TOPICS

(By Charles Pekow, editor, Special Reports, Day Care Information Services, United Communications Group)

Vol. 14 No. 23 October 28, 1985

THE INSURANCE CRISIS: AN UPDATE

Push to make coverage available gets limited results

Day care groups, insurance brokers, underwriters and government officials continue to grapple with the lack of affordable insurance for day care programs that we reported in our 5/27/85 Special Report. "We are still getting 200 calls a week from providers at wit's end," says Deborah Phillips of the National Assn. for the Education of Young Children (NAEYC). This follow-up report looks at some steps being taken around the country to try to resolve the problem.

● NATIONAL EFFORTS FLOUNDERING -- MOST PROGRESS AT STATE LEVEL

Efforts by national groups and brokers to get nationwide policies from major underwriters have met little success thus far. NAEYC's new policy with CIGNA (Day Care USA 7/22/85) won't cover family day care, Head Start or other programs with significant numbers of publicly paid clients, programs operating less than 25 hrs./wk. and programs with staff/child ratios greater than 3-1 for children under two. NAEYC and California's Loma Rica Insurance Agency have separately been pushing for broader standards from CIGNA for months and keep getting the run-around, they say.

CIGNA is "studying it state by state," a company official tells us. It will offer insurance more readily in states that enforce the strictest standards, he says. Covering family day care is at least six months away, says the official, who asked not to be identified. He says the company hasn't even been able to gather detailed regulatory data from more than 10 states, and family day care is harder to insure than centers, because safety in private homes is harder to standardize. "Sex abuse is not the issue," he says. "Life safety standards are." The company is rejecting applications from centers that don't meet its health and safety standards, like maintaining automatic sprinkler systems, he adds. CIGNA is closer to broadening coverage to part-time and government funded centers than it is to offering a family day care policy, he says.

The Child Care Action Campaign (CCAC) and other day care advocates are pushing for a national policy through broker Marsh & McLennan. Several national carriers have rebuffed the broker. But the company says it has seriously interested a large underwriter in covering homes and centers and insuring for child abuse and neglect. The carrier refuses to identify itself until it makes a commitment. A decision could come any day, or could be months away, sources tell us. The company is large and reliable, says CCAC'S Jim Strickland. It plans to cover all classes of regulated providers, from centers to family day care and Head Start. The program might not start in all parts of the country at once, Strickland says.

Rates will vary depending on local claims data, licensing standards and enforcement. They could be prohibitively expensive, some fear. The unidentified company, negotiating through Marsh & McLennan or anonymously with CCAC by

telephone, originally offered rates of about $175/child/yr. for licensed family day care for a claims-made policy, says Maribeth Oakes, family day care advocate for the Children's Foundation. The carrier came down to about $70, still too high for providers -- most couldn't afford more than $30-$40, she says.

Form coalitions with other groups "in the same boat," like nurse midwives, Phillips advises. Get employers on your side -- let them know that the lack of affordable insurance threatens their employee's child care arrangements and therefore employee productivity, she counseled an insurance forum at the recent annual conference of the National Black Child Development Institute. Share concerns with state insurance commissioners, she advised a House panel.

After a few hearings exploring the subject, Congress isn't prepared to mandate a national legislative solution. Some statewide efforts have met with more success than national ones. Their stories follow.

● STOPPING CANCELLATIONS BY GOVERNOR'S DECREE

New Jersey Gov. Thomas Kean decreed an emergency, forbidding insurance companies in the state from canceling day care insurance for 60 days starting Sept. 17. Insurers must renew for an equal length of time any contracts expiring in the period -- i.e., a six month contract must be renewed for another six months. Companies can raise rates upon renewal, though -- the state lacks authority to govern rates. The state sent notices to all licensed centers advising them of the ruling and also issued a press release. The notice included an address in the state Insurance Dept. to write to with comments or suggestions for further action.

Insurance companies can get exemptions only if they persuade the insurance commissioner that they can't afford to continue or want to cease operating in the state. Continuing the ruling over the long run could lead some underwriters to want to get out of the state, officials concede.

The state government also put together some hard data -- that insurance companies say they lacked -- to show that day care is a reasonable-risk business. The licensing bureau conducted a random statewide telephone survey of 8.4% (147) of the state's licensed centers, reports Nick Scalera, assistant director, Div. of Youth and Family Services. Eleven, or 7.5%, reported cancellations at the end of their policies. All found replacements, usually with other carriers, Scalera told the Virginia Commonwealth University Licensing Institute in Richmond VA. "That told us something we were not reading in newspaper clips," he said. 81.5% said they filed no claims within the past five years; 11.6% cited one claim. Less than 1% filed three, with the rest filing two.

"Child abuse was being blown out of proportion," he documented. 85.2% of claims dealt with accidental injury, 7.4% vehicular accidents. Only one claim -- 3.7% of the total -- involved child abuse or neglect, and it was settled without payment, Scalera reported. Regarding costs of claims, 67% were for less than $200.

Scalera brought the data (and figures showing less than 1/10th of 1% of abuse and neglect substantiations took place in licensed centers) to the state Insurance Dept. The division also sent its first Day Care Insurance Alert to all licensed centers, reporting the survey results and that "we were aware of the problem and need their help to solve it. It was two pages, because we know they don't read anything longer," Scalera said. The alert gave names and num-

bers in the insurance department to call in case of problems.

A second alert mailed to centers told them about an out-of-state company willing to write policies for New Jersey centers.

● PROBLEM IS UNIVERSAL, SURVEYS SHOW

While it's hard to get, most states require at least some providers to carry insurance, national surveys show. A survey of state governments conducted over the summer by the Social Services Committee of the National Council of State Human Service Administrators of the American Public Welfare Assn. (APWA) found that 30 of the 40 states responding (including the District of Columbia, Puerto Rico and Guam) put some requirements on providers. A similar survey by the Child Care Law Center (CCLC) found insurance requirements in 20 of 30 responding states. According to the surveys:

• At least nine states require insurance only for providers taking government-paid clients; 11 require insurance only for centers, APWA found. California requires insurance for family day care centers only, APWA reports, though California centers must maintain "sufficient financial resources to retain standards of service," CCLC says.

• Specific amounts of insurance are required only by 13 states. Specifications range from flat figures, such as Florida's $100,000/center, to numbers per child or incident, as Wisconsin's $25,000/person and $75,000/occurrence general liability. Indiana, Montana and Tennessee require only "sufficient" or "adequate" coverage. Nevada doesn't specify figures, but it indicated some of its localities do.

• Rates are increasing for centers and homes, 34 states told APWA. Rate increases range from 10% to 400%. Illinois reported a problem for centers only, and Delaware said it "seems to be harder for centers to obtain reasonably priced insurance." Louisiana reported that, while center rates are increasing, family day care "providers seem to be having the most difficult time getting or keeping insurance."

• Providers have ceased operating because of a lack of insurance in at least nine states, their governments told APWA: California; Texas; Wisconsin; North Dakota; Maryland; family day care in Massachusetts, Nevada and Hawaii; one preschool in Kansas. Most states indicated they didn't know if programs closed for lack of insurance. Several said some providers were on the verge of closing or were operating uninsured. Arkansas reported that insurance problems factored into decisions to close but weren't solely responsible. Hawaii reported that some providers ceased some activities, such as transportation, because of insurance problems. One Hawaii program reportedly "gave up its van when" insurance jumped from $1,500 to $6,000.

• Arkansas found that the problem is less acute for church-related programs than for other providers. The state can't explain why, says Kathy Stegall, Child Development Unit staff manager.

• A few states require insurance only for transportation for some providers, the surveys report. Illinois requires family day care to be insured only for vehicles, APWA reports, while Michigan told CCLC only transportation must be insured.

• Idaho doesn't require provider insurance, but the city of Boise does.

● OTHER DEVELOPMENTS

In other insurance-related developments:

• The threat of legislation was all it took to spur California insurance underwriters to seek a solution. State Sen. John Seymour introduced a bill that would have required all liability insurance companies in the state to participate in a joint underwriting authority to cover day care programs. Seymour set aside the legislation when 26 underwriters agreed to form a voluntary assistance plan. Providers who show they've been rejected by two carriers can approach the group, which randomly assigns three members to bid for the provider's insurance. Seymour indicated that, if the plan doesn't work, he'll push the bill.

• The Washington state insurance commissioner forbade insurance companies from denying, canceling or terminating homeowners' insurance on the grounds that day care is practiced in the home. Underwriters could limit or exclude liability for the day care business, though. California's legislature passed a bill with a similar provision in September. The bill requires underwriters to present annual reports to show whether they're losing money in day care insurance.

• Maryland's insurance commissioner is preparing a voluntary marketing assistance plan (MAP), in which the office will match up providers with underwriters willing to offer insurance. The program would have been up by now if the commissioner hadn't been preoccupied with the state's savings and loan crisis, one staffer suggests. The state needs a formal MAP, because an informal telephone poll didn't work. Underwriters said by phone that they were offering insurance, but they later turned down providers referred to them. Gov. Harry Hughes wants to announce the program personally, we're told.

• An American Insurance Assn. working group on day care hopes to establish a position paper by the end of the year. The paper will cover misunderstanding between insurance and day care industries and may contain recommendations for insurers, group members tell us.

• Minnesota Gov. Rudy Perpich and several other governors asked the National Governors Assn. (NGA) to explore the issue. NGA will probably put out an information packet for governors but doesn't plan any research on the matter, says Roy Simon, senior staff associate for income security and social services of NGA's Committee on Human Resources.

PUBLIC POLICY REPORT

Liability Insurance Update

"I've never had an insurance claim, but my policy was just canceled."

"I'm calling everywhere for insurance, but in the meantime I need proof of a policy to renew my lease."

"I've been setting aside funds for the Center Accreditation Project, but now I need to use them to cover my increased insurance premiums."

"I can't believe I have to choose between closing my program or operating without insurance."

"This is a nightmare!"

Sound familiar? We receive 200 calls like this every week at NAEYC Headquarters. You are not alone, but this provides meager comfort as you grapple with your insurance problems.

Your most important task is to remain informed, assertive, and determined to find a solution. It is very easy to begin to feel helpless and defeated. The recommendations here will help you fight these feelings. They will also tangibly contribute to your efforts, as well as NAEYC's efforts, to make affordable, dependable insurance coverage available for child care programs.

What is happening?

The current insurance crisis has four parts.

Access: Insurance for programs is being canceled midterm or not renewed, and replacement policies are exceedingly difficult to find *at any price*.

Affordability: Programs that do find insurance are assessed rate increases anywhere from 100% to 600%; 300% to 400% increases seem to be the norm.

Predictability: Nonrenewals and rate hikes affect programs regardless of their claims history, quality, and years of operation. Moreover, programs often are given one month's notice or less.

Coverage: Almost all companies that still carry child care programs exclude child abuse and sexual molestation from coverage. Many other new exclusions and eligibility criteria are also being applied.

Why is this happening?

The underlying reasons for the current insurance crisis are primarily economic. For the past several years, the insurance industry has benefited from high interest rates that produced high returns on their investments. Today, that situation has reversed, leading insurers to scrutinize their policies in an effort to prevent major financial losses. The result has been an almost complete withdrawal from several areas of coverage, including nurse midwives, municipalities, obstetricians, and child care providers.

Child care is on this list of presumably risky (and therefore unprofitable for the insurance industry) businesses even though insurance companies have not kept records on premiums and losses specifically for child care. The sensationalistic headlines about child abuse in child care settings have had a profound effect on insurance companies' perceptions of the risks involved in providing child care. Given the phenomenal number of lawsuits filed in our society, the combined effect of these factors has been the insurance industries' extreme hesitation to write child care policies.

What is the result?

When faced with no insurance carrier or budget-breaking rate increases, programs must make some difficult trade-offs, depending on the income bracket of the families served and state licensing requirements.

Some programs may decide to operate without insurance. This is not only unwise, but also is illegal in states that require licensed programs to carry liability insurance.

Programs serving parents who are able and willing to pay more for their child care may pass the premium hikes on to the parents.

Programs that rely on government subsidies or that serve

low-income families have no option except to cut program quality or to close down. This will seriously reduce the availability of licensed child care for low-income families.

What is being done?

Although child care is not the only business characterized as risky by the insurance industry, our profession has received by far the greatest publicity and concern. Media coverage has been extensive and highly positive.

Some states, such as California, have drafted legislative responses to the child care insurance shortage. The California legislation prompted insurers in that state to establish a voluntary alternative to government intervention—a Marketing Assistance Plan. At the federal level, U.S. Representative George Miller has held two hearings on the issue and has surveyed each states' insurance commissioner. Several other members of Congress are also tracking the situation and considering federal legislative responses.

Within the insurance industry there are a few good faith efforts to develop a solution voluntarily without government intervention. NAEYC is working with other national child care organizations to facilitate these efforts by providing accurate information about child care.

In many states, regional and statewide child care coalitions have been formed to develop strategies to document, cope with, and remedy the insurance crisis. In Maryland, for example, the state Office for Children and Youth and the Maryland Committee for Children have formed an insurance task force. In other states, such as Colorado, Pennsylvania, and Florida, provider groups have formed coalitions around this issue.

What can I do?

Don't panic! There are many constructive steps you can take.

1. Find out what your insurance agent and carrier know about child care. Often they have inaccurate or incomplete information and make decisions based on these misperceptions. Be prepared to educate your insurers about the professional delivery of child care.

Think of this task as your way to replace media-driven concerns about child care with more positive impressions. To be effective, offer a business-like, professional documentation of facts. This not only serves to educate, but also affirms your image as a professional for whom insurance is a necessary part of doing business.

2. Document your program's entire insurance history. Note the name of your carrier, the type and extent of coverage, the premiums, and any claims filed and paid. In addition, document any recent changes in your insurance policy and the measures you have taken to obtain affordable insurance with adequate coverage.

3. Adopt and document measures to reduce your level of risk.

- Use systematic and careful screening methods to hire employees. Set up probationary periods for new staff.
- Keep your staff-child ratios as high as possible. Draft an emergency plan that assigns the maximum number of staff to children possible.
- Prepare written operating procedures, policies, and personnel requirements.
- Ensure that all staff participate in training programs, such as sessions on first-aid and child abuse prevention.
- Allow parent visitation at any time.
- Develop a stringent system to supervise all staff.
- Document how the physical safety of children is protected in your program: staff first aid training, collaboration with medical practitioners, and safety practices for field trips.

4. Inform your insurance agent/company about your experiences, options, and likely responses at every step from your first receipt of a nonrenewal or rate increase. Send them copies of all letters you write (see #6). Send them a copy of your program's insurance history and regular updates to reflect your efforts to obtain insurance.

5. Before you call every insurance company in the phone book, first call your insurance commissioner (usually in a state office of insurance). This office should maintain current information on the companies that still write child care policies in your state. Keep track of every insurance company you contact, and their responses to your request for insurance, including anticipated and actual delays between initial contact and an effective policy.

6. Write a business letter describing your predicament to your state insurance commissioner. Document your child care license or explain why you are not licensed (e.g., the state does not license part-day programs), your insurance history, and your program quality (see #3). Send copies of this letter to your state and federal government representatives, and your state or local child care licensing office.

7. Meet regularly with parents of children in your program. They need to remain informed about the problem and to be part of the decision process as a solution is sought. Encourage them to write to the insurance commissioner and government representatives. Parents can be especially effective in documenting the repercussions of the insurance problems and stressing the likely effects on their jobs and families.

8. Write an editorial for your newspaper. Appear on radio and television talk shows. Make presentations before your city council and civic organizations. Keep the problem visible in your community.

9. Collect data. NAEYC depends on you to keep us informed about the scope and nature of the problem. We can magnify our effect on the media, the insurance industry, and federal policy makers when we can provide data such as numbers of programs that have experienced nonrenewals, average sizes of rate increases, and numbers of programs that have ceased to operate. Ask for a sample survey form (see end of this article).

10. Plan ahead. Start several months before your insurance renewal date, so you will not be left without coverage.

What about NAEYC's insurance policy?

Throughout the last year, NAEYC worked with MarketDyne International (a division of CIGNA Corporation) to develop a child care center property and casualty insurance package that includes liability coverage. This NAEYC Safety Group Program offers property and center liability coverage, as well as optional automobile, workers' compensation, and student accident medical coverage. The maximum liability coverage is $500,000 per occurrence. Coverage for child abuse or sexual molestation is unavailable. We anticipate that rates will run $2 per 100 square feet for the liability portion of the policy. The annual premium for the full package will probably average $1,800, without the optional automobile, compensation, or student accident coverage.

Eligibility qualifications are quite stringent and include only programs that:

1. Have a capacity of 10 or more children, not provided in a private residence. This includes after-school care that meets all other criteria.
2. Operate at least 25 hours a week, or a minimum of 4 hours a day.
3. Enroll a majority of nonhandicapped children. A small proportion of handicapped children, as in mainstreamed classrooms, may be enrolled.
4. Maintain an emergency plan documenting staff-child ratios of 1:3 for children under 2; 1:5 for children ages 2 to 3; 1:10 for children ages 3 to 5; 1:12 for children ages 5 to 7; and 1:15 for older children. These ratios do not need to apply during routine care and education, but must include only regularly scheduled staff on the premises.
5. Have limited government financial participation or support.
6. Are licensed or exempt from licensing by state statute.
7. Employ staff trained in child development and/or early education, use careful hiring practices and a probationary period, and maintain constant adult supervision.

Ineligible operations include summer camps, family day care homes, overnight facilities, and centers specializing in work with handicapped or disabled children.

Each program that applies for coverage will complete a supplemental application—a preliminary screening form. You may request a copy of this application from MarketDyne. Once this form is processed, a local CIGNA inspector will probably conduct an on-site inspection of your program. This process can take from 6 to 8 weeks, so anticipate your deadlines as much as possible.

NAEYC's goal is to see that this plan is available to NAEYC members in every state. This is not now the case, although the situation is changing rapidly. We recognize that this policy will not solve the problem for everyone, and we are continuing to advocate for broader coverage for all types of child care programs.

For information about this plan, phone 800-523-2710 and ask for Robert LoConte. If you have *any* problems, and feel you meet the criteria outlined above, please call NAEYC Headquarters. We also want to keep track of states that are not writing this policy.

What else is happening?

In addition to the MarketDyne policy, negotiations are drawing to a close on another child care insurance policy that may be available in January. The Child Care Action Campaign (CCAC) worked over the summer with a coalition of child care representatives including NAEYC and a major brokerage firm in New York City.

The negotiators are extremely optimistic that an affordable child care policy will be made available. The policy would cover all licensed forms of child care—centers and family day care homes—and would not contain restrictions based on government funding or hours of operation. Moreover, an effort is being made to cover child abuse allegations.

Programs covered by this policy would be required to comply with basic safety guidelines, such as having smoke detectors and written evacuation plans, developed in conjunction with the child care coalition formed by CCAC. They would serve the dual purpose of protecting the integrity of the insurance program (thereby keeping rates as reasonable as possible), and assuring that clearly unsafe programs are not pooled with all other programs. Compliance would be subject to verification by a third party such as a child care licensing official, the administrator of a family day care association, or a designated volunteer group. Programs that are not in compliance would be given an opportunity to make necessary improvements prior to loss of coverage.

We will inform NAEYC members about this policy if and when it becomes available.

Where does this leave me?

We hope it leaves you poised for action. Call NAEYC with further questions, insights, creative strategies, and success stories. We will pass them on as we talk with other providers and child care advocates.

If you would like a copy of a sample insurance survey form for providers, send a self-addressed, stamped envelope to the Child Care Information Service at NAEYC Headquarters. And be sure to send us the results. We anticipate there will be more federal hearings and other opportunities to publicize this critical issue.

For information about NAEYC Safety Group Program call MarketDyne International, 800-523-2710 or 800-643-2020 (Pennsylvania residents only). For *specialized* questions, ask for Robert LoConte.

To obtain a copy of the sample insurance survey form, send a self-addressed, stamped envelope to

Insurance Survey Form
Child Care Information Service
NAEYC
1834 Connecticut Ave., N.W.
Washington, DC 20009-5786

Senator SASSER. Thank you, Mr. Stephens.
Mr. Hackett.

STATEMENT OF WILLIAM R. HACKETT, EXECUTIVE DIRECTOR, COMMUNITY DAY CARE AND COMPREHENSIVE SOCIAL SERVICES ASSOCIATION, MEMPHIS, TN

Mr. HACKETT. Thank you, Mr. Chairman, members of the committee staff, ladies and gentlemen. I am William Hackett, executive director of the Community Day Care and Comprehensive Social Services Association.

Community Day Care and Comprehensive Social Services Association has provided administrative and fiscal management services to private, nonprofit social services programs in Memphis, TN, for the past 15 years. The association itself is a private, nonprofit corporation chartered and incorporated in the State of Tennessee to promote the general welfare of the citizenry through the coordinated management and provision of social services to individuals, children, and families.

CDC&CSSA has, for the past 15 years, held contracts with the Tennessee Department of Human Services, the city of Memphis, and Shelby County, in addition to various other entities of the State and Federal Government. We currently provide through subcontracts with private nonprofit charitable groups day care for children——

Senator SASSER. Mr. Hackett, excuse me. Could you pull that mike just a little closer to you?

Mr. HACKETT. We currently provide day care for children; day-care services for senior citizens; foster care services; transportation services for aged or disabled adults; protective service emergency home shelter for children; day-care services for handicapped children, and after school and summer day-care services for school aged children.

In the interest of assuring that the association's subcontracted programs and grantor entities were adequately and consistently insured, the negotiation and procurement of insurance coverage for the programs has been reserved and consolidated as a responsibility of the administrative management provided by CDC&CSSA. This consolidation of property/casualty insurance procurement is only one aspect of numerable functions consolidated under the management auspices of the association, for economies of scale or efficiency.

The combined fiscal year 1986 budgets of the subcontract programs managed and supervised by the association for which we negotiate insurance total $3,392,200. The multi-peril liability property and casualty coverage our broker is asked to place encompasses 14 day-care center locations providing 15 separate programs for children and one for adults; six group homes for children in foster care; the association's offices; eight vans and school buses, and five automobiles or utility vehicles. In addition, fidelity bonding; loss of valuable papers; comprehensive glass breakage; client accident insurance; workmen's compensation insurance, and directors and officers liability insurance comprise the balance of the coverage.

As square footage is an actuarial aspect of liability coverage, the programs utilize and insure building premises of 81,819 square feet and 14 playgrounds. The expressed value of buildings owned and insured is $1,162,200 and contents of $200,000. A potential 1,305 children and/or adults are served on any given day of operation.

CDC&CSSA has enjoyed a very positive working relationship with the E. H. Crump and Co. insurors over the past 4 years. During 2 of those 4 years, the Crump Co., through their brokerage activities, assisted in the planning, placement, and management of the association's insurance coverage when the association also managed and operated an Office of Juvenile Justice Delinquency Prevention Federal Demonstration project, serving 25 violent juvenile offenders in a "secure" penal facility environment.

The annual insurance premiums paid by the association prior to fiscal year 1986 were relatively fixed for 3 fiscal years. Therefore, we feel that the increases in the association's premium costs are illustrative of dramatic increases in certain insurance lines for day-care providers throughout the marketplace. A comparison of the premiums paid by the type of coverage for the fiscal year 1985 and 1986 follows.

Directors and officers liability, $1 million, a 50-percent increase, from $1,351 to $2,027.

Property, a 42-percent increase, from $3,894 to $5,519.

General liability, $300,000 and $300,000, a 1,697-percent increase from $3,080 to $52,280.

Senator SASSER. That is the increase in your premium?

Mr. HACKETT. Yes, sir.

Senator SASSER. A 1,697-percent increase?

Mr. HACKETT. That's correct. Right, sir.

Under multi-peril, a 10-percent increase from $844 to $926.

Our commercial umbrella excess liability with a $5 million limit, for which we paid $1,850 in 1985, is not being renewed.

Client accident insurance remained the same, $2,730.

Our automobile policies increased by 280 percent, from $8,091 to $22,699.

Our automobile excess liability of $1 million, at $510, was not renewed.

Senator SASSER. Was not renewed?

Mr. HACKETT. Was not renewed.

Workmen's compensation increased by 30 percent from $6,044 to $7,843.

In total, we experienced a 331-percent increase in our premiums from a 1985 premium base of $28,394 to a 1986 premium base of $94,024.

Senator SASSER. Let me stop you there and ask you, Mr. Hackett, can you give me any explanation as to why your general liability insurance would increase 1,697 percent in 1 year?

Mr. HACKETT. Market forces.

Senator SASSER. You said market forces?

Mr. HACKETT. Market forces.

Senator SASSER. All right, sir.

Mr. HACKETT. Discussion with the chief executive officers of other social service agencies, hospitals, local and State governments and school systems, as well as newsletters and other printed

communications from professional organizations and groups with whom we are affiliated, indicate that the Association's insurance status is no worse and in many cases much better than that of similar social service organizations. We understand that the crisis which child care providers are facing in securing liability insurance has been addressed in hearings of the Select Committee on Children, Youth and Families, and the Subcommittee on Tourism, Transportation, and Commerce of the House of Representatives. Additionally, reports issued to the Senate Finance Committee this year by the General Accounting Office addressed the need to reexamine the Tax Code dealing with property/casualty insurance companies in view of the profits generated in the insurance industry and loopholes in the Tax Code.

Social service organizations such as the NAEYC, the Child Care Action Campaign, the Child Welfare League of America, the Children's Foundation, the National Association for Family Day Care, the School-Age Child Care Project, and the National Head Start Association, to name only a few, have begun survey efforts among service-providing agencies and the insurance Commissioners in all States regarding liability claims and loss data.

To date, the efforts of these groups and the actions of State Commissioners of Insurance have brought about the cessation of cancellations in mid-policy year and joint underwriting pools in some States. However, nothing has transpired to our knowledge which indicates that the insurance industry will provide affordable coverage, decrease the high premiums, or provide more coverage to child care providers.

As an analogy, we feel the exorbitant premium increases in the insurance industry and their rapid escalation seem to parallel the oil embargo of the 1970's. Hopefully, the reports of the General Accounting Office and like information will be studied and utilized by Congress to prevent the accumulation of windfall profits within the insurance industry.

In discussions with staff of the State of Tennessee Department of Commerce and Insurance, we have inquired about joint underwriting or assigned risk pools and self-insurance coalitions as potential alternatives to the problem. It is our understanding that legislation would be required were the insurors unwilling to voluntarily establish such alternatives. Should those alternatives be voluntarily established, and the high premium costs, restrictions and exclusions to the coverage provided by the industry not be relieved, the quality and quantity of service we provide will have to be diminished.

In conclusion, we have found very few alternatives to suggest beyond some form of State or Federal intervention. Ultimately, legislation may be needed to set legal limits on liability in order to defuse the volatile liability insurance premium hikes.

In the case of social service programs such as those of the association, which receive significant Government financial participation, serve low income and handicapped persons, and have no means to pass on the premium increases to our consumers, a federally-assured reinsurance for social service liability carriers may be necessary to bring policies within fiscal reach.

Lastly, if the crisis persists or increases, we would suggest Congress pass a liability program similar to the Federal Flood or Crop

Insurance Programs to assure the protection of the human service agencies, Head Start Programs, public and private schools, and the like.

Thank you.

[The prepared statement of Mr. Hackett follows:]

Committee on Small Business
United States Senate

November 16, 1985

Statement of William R. Hackett, Executive Director,
Community Day Care and Comprehensive Social Services Association

Mr. Chairman, members of the Committee Staff, and Ladies and Gentlemen:

Community Day Care & Comprehensive Social Services Association has provided administrative and fiscal management services to private, non-profit social services programs in Memphis, Tennessee, for the past fifteen years. The Association itself is a private non-profit corporation chartered and incorporated in the State of Tennessee to promote the general welfare of the citizenry through the coordinated management and provision of social services to individuals, children and families.

CDC&CSSA has, for the past fifteen years, held contracts with the Tennessee Department of Human Services, the City of Memphis and Shelby County in addition to various other entities of the State and Federal government. We currently provide through subcontracts with private non-profit charitable groups: day care for children; day care services for senior citizens; foster care services; transportation services for aged or disabled adults; protective service emergency home shelter for children; day care services for handicapped children and after-school and summer day care services for school aged children.

In the interest of assuring that the Association's subcontracted programs and grantor entities were adequately and consistently insured, the negotiation and procurement of insurance coverage for the programs has been reserved and consolidated as a responsibility of the administrative management provided by CDC&CSSA. This consolidation of property/casualty insurance procurement is only one aspect of numerable functions consolidated under the management auspices of the Association, for economies of scale or efficiency.

The combined FY 86 budgets of the subcontract programs managed and supervised by the Association for which we negotiate insurance coverage total $3,392,200. The multi-peril liability property and casualty coverage our broker is asked to place encompasses fourteen day care center locations providing 15 separate programs for children and 1 for adults, 6 group homes for children in foster care, the Association's offices, eight vans and school buses and five automobiles or utility vehicles. In addition, fidelity bonding, loss of valuable papers, comprehensive glass breakage, client accident insurance, workmen's compensation insurance and directors and officers liability insurance comprise the balance of the coverage.

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	FY 1985	FY 1986	% Increase <Decrease>
Directors and Officers Liability ($1,000,000)	$ 1,351	$ 2,027	50%
Property	3,894	5,519	42%
General Liability ($300,000/$300,000)	3,080	52,280	1,697%
Multi-peril	844	926	10%
Commercial Umbrella Excess Liability ($5,000,000)	1,850	-0-	<100%>
Client Accident	2,730	2,730	
Automobile	8,091	22,699	280%
Automobile Excess Liability ($1,000,000)	510	-0-	<100%>
Workmen's Compensation	6,044	7,843	30%
Total	$28,394	$94,024	331%

Discussion with the chief executive officers of other social service agencies, hospitals, local and state governments and school systems, as well as newsletters and other printed communications from professional organizations and groups with whom we are affiliated, indicate that the Association's insurance status is no worse and in many instances much better than that of similar social service organizations. We understand that the crisis which child care providers are facing in securing liability insurance has been addressed in hearings of the Select Committee on Children, Youth and Families, and the Subcommittee on Tourism, Transportation, and Commerce of the House of Representatives.

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In conclusion, we have found very few alternatives to suggest beyond some form of State or Federal intervention. Ultimately, legislation may be needed to set legal limits on liability in order to defuse the volatile liability insurance premium hikes. In the case of social service programs such as those of the Association, which receive significant government financial participation, serve low income and handicapped persons, and have no means to pass on the premium increases to our consumers, a federally assured re-insurance for social service liability carriers may be necessary to bring policies within fiscal reach. Lastly, if the crisis persists or increases, we would suggest Congress pass a liability program similar to the federal flood or crop insurance programs to assure the protection of the human service agencies, Head Start programs, public and private schools, etc.

Thank you.

Senator SASSER. Well, thank you, Mr. Hackett, for a very comprehensive and informative statement.

Ms. Boshers.

STATEMENT OF EVELYN R. BOSHERS, PRESIDENT, ASSOCIATION OF FAMILY GROUP AND DAY-CARE HOMES, NASHVILLE, TN

Ms. BOSHERS. My name is Evelyn R. Boshers. I am president of Family Group and Day-Care Homes. I've been in the group day-care business for 15 years. I've always had liability insurance.

As president of Family Group and Day-Care Homes, I urge all of my 140 members to acquire such insurance. Unfortunately, not everyone can afford liability insurance, which now leads us to two choices: one, operate uninsured; or sacrifice our quality of service. It's just not fair for some of us to have to choose between two choices. Day-care businesses are people business, and children are people, too, which makes them our business. Children should not be subject to a poor quality of service. Something has to be done about the liability insurance.

Until a few months ago we did not have a problem with our liability insurance. All at once, the insurance providers started canceling, leaving them without any insurance. A great many of us feed Human Services children—the WIN children, the out-of home children—and without liability insurance we cannot transport these children, which we pick up in the mornings, sometimes at 5:30 or 6 o'clock. They are not returned home; if they are under protective service, they stay as late as possible. Sometimes it's 6 o'clock or after when these children are taken back home.

We contacted a Steve Cross [phonetically] Insurance Co. to find out about the insurance, so many had been canceled. He quoted us a price of $335 a year. Since we're in kids, it seems so little; but yet, with the group day-care homes, with no more income than they have, it seems a big price.

He signed up 50 of our members, and then he let us know that the price went up $100——

Senator SASSER. A hundred dollars from what?

Ms. BOSHERS. It went up $100 after he had already priced 50 new members—he said he was told that the price would go up to $100. A lot of our people, he would not even sign up, the ones that were just on a day-care basis; like, they have seven children. A group home feeds 12; a regular day care feeds only 7. And he would not take the ones that take the seven children in their homes.

A lot of our rates start at $25. You might think that's very little, and it really is; $25 to $27.50, and then a lot of them get $45, but most of our members feed Human Services children, which are $27.50, and $0.50 for picking them up in the morning and $0.50 for taking them home at night. That's $27.50 that they get for Human Services children. And, of course, a lot of us live in poor sections where there is only 1 parent and the parent cannot afford to pay very much for day care. So a lot of us feed from the $25 a week.

Without the reimbursement we get from USDA, we couldn't possibly make it. We just barely exist from that. So if the liability insurance is going to jump very high, I don't know how group day-care homes and day care are going to survive it. It was bad enough

like it was, but now since this—I talked with one of the people from Human Services who said that if the increase got real high it might be possible that we might get an increase in our day-care from Human Services. But we know we have to have the liability insurance in order to stay in business, and that's what so many are so upset about it because if we lose our liability insurance—if we cannot afford to keep it—that means we would not have the Human Services children.

I'm open for any kind of suggestions that we might be able to cope with at this time because at this time, we're just really all upset about it. We cannot find another insurance provider at the present time. We still have a lot of members that are not covered. We've only gotten these 50 from Steve Cross, and then some of them do have private concerns where they didn't have their automobile and their liability together; but then there are some, the Winners, that are hanging on. They don't have any insurance at all right now. At this time, we just don't know where we stand.

Senator SASSER. Well, thank you, Ms. Boshers.

Let me just ask you panelists here some questions.

There are almost 4½ million mothers of children under 3 years of age across this country who are either working or actively seeking employment. Here in Tennessee, there are 92,000 children who are in day-care centers; 17,000 of these children are right here in Davidson County.

Now, given these figures, I'm very concerned about the impact of the insurance crunch on a very badly-needed and vital and, I'd say, critical service. Indeed, I don't think it's an overstatement when the Nashville Tennesseean, the morning newspaper, reported earlier this month that steep increases in insurance premiums, quoting the Tennessean, "threatened the continuing care of thousands of Tennessee children."

Now, does this panel agree with this assessment of the impact of the insurance prices on day-care services here in Tennessee? Do the insurance prices and the escalating insurance premiums indeed threaten the continuing care for thousands of children in day-care centers here in this State?

Do you want to address that, Mr. Hackett?

Mr. HACKETT. As I stated, and as I hear Ms. Boshers stated—Mr. Stephens made another reference to the smaller agencies—we have consolidated smaller agencies under our authority. We would not be able to pass—and will not be able to pass—through the insurance increases which we've experienced this year. Unless the charitable organizations such as the United Way or the city or the Federal Government make available to us some additional source of funds, we will have to reduce our services. In our instance, I estimate that we might have to close programs serving approximately 100 children. That's approximately 10 percent of all the children that we are now serving.

Senator SASSER. So the situation for a larger operation like yours is, you're simply going to have to shut down a part of the service?

Mr. HACKETT. That's correct.

Senator SASSER. Because you cannot pass through the increased insurance premiums? And I judge that many of the smaller day-care centers, like Ms. Boshers referred to earlier, will simply either

close down—go out of business—or attempt to operate uninsured. Is that a fair statement, Ms. Boshers?

Ms. BOSHERS. Yes, it is.

Senator SASSER. All right.

Now, this is, to me, a troubling forecast because we've got thousands—tens of thousands, really—of mothers in this State who allow the day-care centers to look after their children while they're working. In many instances, these are single parent households and the mother has to work to support the family; or, in other instances, both the mother and the father work, in order that they can have a better quality of life. These problems are going to work, great hardships and cause great frustrations and great disappointments to literally tens of thousands of our citizens in this country.

Now, what's going to happen if we simply wait for the marketplace to correct the current difficulties in the insurance industry? Do you feel that we ought to just wait for the market to handle this situation, or should Government take a more active role in attempting to fashion some appropriate and reasonable remedies to this problem?

Mr. HACKETT. I think we've shown what losses we face.

Senator SASSER. Well, let's hear it for the record, now. We're trying to make a record here, and I want to hear what you all say about it.

Ms. BOSHERS. I think the Government should take the lead. I don't think we should wait around for debate because so many people will be out of business, and these people—the group day-care homes and the day-cares, they don't get much of a real good name. The centers mostly get all of the good name. But when it boils down to it, the group day-care homes, they are really the homes because a child never leaves the home with a dirty face or dirty clothes. That child is well-fed, and if you think that child is not going to have anything to eat when it gets home—maybe food stamps are late or some reason or another, the mother has been out of work some during the week—you feed that child supper before he leaves. You know that child is going to have a full stomach when it comes back the next morning; it's not going to be hungry during the night. It doesn't go home with dirty clothes; if you have to take them off, put something else on it and wash them and put them back on—and this whole thing, maybe if you think that mother doesn't have anything to eat, you go to your kitchen and you take something off your shelf and you put it in a bag or something when that child goes home. Little things like that; that's what our group day-care homes do, and that's what day-care—I know my people; I know my providers, and every one of them feels as I feel that that child is important, and it comes first.

How many centers do you see that the children go home like that? We should have as good a name as the centers, but sometimes we don't. We're baby-sitters to a lot of people, but we're not; we're a small business, and children is our business. And we try to take care of them.

Senator SASSER. Well, thank you very much, Ms. Boshers.

Mr. HACKETT. Listening to what Ms. Boshers is saying, group day-care homes are the primary source of care for the infant to 15-month-old children. So I believe her testimony is made in behalf of

those families who are in need of care for infants up to a point that those children can be served in a regular day-care center. I certainly am in agreement with what she said.

Senator SASSER. Did you want to add something, Mr. Stephens?

Mr. STEPHENS. Yes, sir. Senator Sasser, in all four of our centers that we have, we have an extremely large waiting list of people trying to get in. We have actually gotten to the place that the mothers call us the day they find out they are expecting, to be put on the waiting list to get their child in. When you combine that fact with the fact of the earlier statistic that I quoted, that they're projecting, even in the marital area, in the next few years, 10,000 spaces—more than we have now—this really concerns us. And in answer to your question, I don't think we can wait for the marketplace to take care of it because we're already very far behind. And if we have one center that closes down, we've lost that many kids; we have no place to put them. So I don't think we can wait for the marketplace to take care of itself as far as child care is concerned.

Senator SASSER. Mr. Hackett, you indicated that you had inquired about joint underwriting or assigned risk pools or self-insurance coalitions with the State Department of Insurance. What was the upshot of those discussions?

Mr. HACKETT. The market plan that Commissioner Neff, I believe, has discussed as an outgrowth of that; however, their reply to us was that the things that we were proposing would require legislation and we would not see any relief in that respect until after the next legislative General Assembly, per se.

Senator SASSER. So if you were going to make some progress in the field of joint underwriting or assigned risk pools or self-insurance coalitions, this would require legislation; is that right?

Mr. HACKETT. As I understand it, right. That is, of course, if we deal only with the State.

Senator SASSER. Now, the Commissioner indicated that this problem is isolated to just a few businesses. Is that your experience here, or is it more extensive than that?

Mr. HACKETT. That has not been my finding, Senator. As I stated in my statement, I've talked to hospital administrators in Memphis, the city government, the school board personnel for both public and private schools, public libraries, fellow social service administrators, and some 53 under United Way auspices. They're all sharing the same kind of information with price increases of over 100 percent.

Senator SASSER. Well, I must say, that's what we're hearing in the mail that we get in my office and the inquiries and the statements that I get as I travel across the State from individual business people. I haven't seen such an outpouring in a long time.

I want to thank you very much for appearing here today and for giving us the benefit of your views. It's been very helpful. Thank you.

Our next panel will consist of Mr. David Booth, the chairman of EMPE, Inc.; Mr. Alan Oakley, a partner in Willard Oakley & Son here in Nashville; and Bill Cameron, the chairman of the board and chief executive officer of Cameron Oil Co. in Franklin, TN

Gentlemen, I welcome you. We're delighted to see you here today. Mr. Booth, you're first here on the list, so we'll start off with you.

STATEMENT OF DAVID BOOTH, CHAIRMAN, EMPE, INC., NASHVILLE, TN

Mr. BOOTH. Senator Sasser, I appreciate very much the opportunity of making this presentation.

The cost and availability of liability insurance for our firm have become matters of crisis proportion. During the past 12 months our general liability premium has increased from $14,900 to $17,100 annually, but our professional liability premium has increased from $15,200 to $33,200 annually. Our major concern, however, is that by January, 1986, all work done on hazardous waste projects will be excluded from coverage. This exclusion will apply ultimately, within a year as we understand it, to general liability as well as professional liability.

Currently, the best efforts of technology should be focused on hazardous waste control and cleanup; but the inability of our casualty coverage system to deal with the problem has placed a tourniquet on the problem-solving delivery system. The options left for those in hazardous waste work are very limited. We may refuse to perform work on hazardous waste projects, or we may seek indemnification by our clients. For all involved in such work to discontinue their efforts would be disastrous to our environment. To assume that our industry could assimilate the claims which have characterized hazardous waste suit awards would be unwise. In fact, it may be beyond the capacity of any insurers to withstand such claims. Limited or total indemnification has the greatest promise of any alternative. However, as you may understand, it is very unpopular with clients. It may also encourage a degree of irresponsibility if proper precautions are not taken. Nonetheless, it still offers immediate relief for the professionals and will allow cleanup efforts to continue.

It seems that the ultimate solution to this dilemma lies in revising tort liability statutes. This process may be very complex and undoubtedly should be approached with due caution. But a system which assesses strict liability upon even those assisting in problem solution must be modified. The Tort Policy Working Group established by Attorney General Meese is a most positive move in addressing the matter.

In the interim, it may be wise for the U.S. Environmental Protection Agency to offer what would amount to a limited amount of reinsurance. It is my understanding that such legislation is now pending in Congress. This may well be the only viable solution for pursuing the Nation's hazardous waste cleanup program.

As a responsible professional, I understand adjustments to market conditions. The insurance industry cannot survive with a bottom line written in red; neither can professionals practice with unlimited, uninsured liability. There must be a realistic limiting of liability, coupled with professional responsibility at the highest level. This country has the ability to deal with our environmental

problems, but this impediment must be removed if we are to be successful in our efforts.

I appreciate the opportunity of making this presentation to you, Senator.

[The prepared statement of Mr. Booth follows:]

PREPARED STATEMENT OF DAVID BOOTH, CHAIRMAN, EMPE, INC., NASHVILLE, TN

Senator Weicker, Senator Sasser, other Senate members, staff members, ladies and gentlemen, as a member of the small business community, I appreciate the opportunity to make this presentation.

The cost and availability of liability insurance for our firm have become matters of crisis proportion. During the past twelve months our general liability premium has increased from $14,900.00 to $17,100.00 annually, but our professional liability premium has increased from $15,200.00 to $33,200.00 annually. But our major concern is that by January, 1986, all work done on hazardous waste projects will be excluded from coverage. This exclusion will apply ultimately, i.e. within a year, to general liability as well as professional liability.

Currently the best efforts of technology should be focused on hazardous waste control and clean-up. But, the inability of our casualty coverage system to deal with the problem has placed a tourniquet on the problem solving delivery system. The options left for those in hazardous waste work are very limited. We may refuse to perform work on hazardous waste projects; we may assume the liability attendant to such projects; or we may seek indemnification by our clients. For all involved in such work to discontinue their efforts would be disastrous to our environment. To assume that our industry could assimilate the claims which have characterized hazardous waste suit awards would be unwise. In fact it may be beyond the capacity of any insurers to withstand such claims. Limited or total indemnification has the greatest promise of any alternative. However, it is very unpopular with clients. It may also encourage a degree of irresponsibility if proper precautions are not taken. Nonetheless, it still offers immediate relief for the professionals and will allow cleanup efforts to continue.

It seems that the ultimate solution to this dilemma lies in revising tort liability statutes. This process may be very complex and undoubtedly should be approached with due caution. But a system which assesses strict liability upon even those assisting in problem solution must be modified. The Tort Policy Working Group established by Attorney General Edwin Meese is a most positive move in addressing the matter.

In the interim it may be wise for the USEPA to offer what would amount to a limited amount of reinsurance. It is may understanding that such legislation is now pending in Congress. This may well be the only viable solution for pursuing the nation's hazardous waste cleanup program.

As a responsible professional, I understand adjustments to market conditions. The insurance industry cannot survive with a bottom line written in red. Neither can professionals practice with unlimited, uninsured liability. There must be a realistic limiting of liability coupled with professional responsibility at the highest level. This country has the ability to deal with our environmental problems, but this impediment must be removed if we are to be successful on our efforts.

Thank you for allowing me to bring this matter to your attention.

Senator SASSER. Thank you, Mr. Booth.

Mr. Oakley, could we move to you now, please?

STATEMENT OF ALAN D. OAKLEY, PARTNER, WILLARD OAKLEY & SON LUMBER CO., NASHVILLE, TN

Mr. OAKLEY. Senator, I just want to thank you—before I get started here—for coming down to see us. I want to thank you and Mr. Nourse and Mr. Wilson for coming down; Lord knows you've got enough to do, and I really appreciate it.

Senator SASSER. Well, you're quite welcome.

Mr. OAKLEY. My name is Alan Oakley. I'm in the lumber business with my dad in Nashville, Willard Oakley & Son Lumber Co. My family has been in the lumber business since the early 1940's

here in Nashville. I've been active in this business since 1972. Since then, we have had just a few very minor claims; we had a stolen trailer one time, and a tool box stolen. We have never had a workmen's compensation claim—knock on wood, there.

In 1983, our renewal premium was $12,240. In 1984, it was $13,039. In 1985 it was $31,808, which hit me pretty hard, I don't have to tell you. I just picked up the phone and called a few people that I knew in business. I noticed that Mr. Neff here was talking about citing just a few examples, selected examples. I didn't select anybody; I just picked up the phone. I talked to Mr. Carl Griffis, who is a roofing contractor here in Nashville—and I'll speak in round figures—his premiums went from $21,000 to $67,000 in one year. Mr. Lendell Greer at West Nashville Wrecker Service, a towing company, the premium went from $14,000 to $30,000. Mr. Jay Dennis of Rock Products Insulation Co., his premiums went from $12,000 to $22,000. A local hardware company here in Nashville, their premiums went from $32,000 to $76,000. And I just spent one afternoon doing this; so as to his "selected" or "isolated" cases, I think he's wrong.

He mentioned—Mr. Neff—50 percent to 80-percent cuts. I haven't seen that anywhere. My premiums have never had any kind of cut like that. He also blamed the rates that we're receiving in some part on the interest rates going so low; I think that high interest rates were the tail end of 1979 and the early part of of 1980. We never had interest rates like that prior to that, and I never had premiums like this prior to that. So I just don't think that washes.

He mentioned that State Farm Insurance here was doing a pretty good job in holding their rate increases down. I talked to—we've heard enough on day-care centers, I think—but I've talked to a little lady named Mrs. Dorris Vernon who said she's been in the day-care center business for 13 years and never had a claim, and they wrote her a letter and canceled completely. So she's just closing up. That makes me kind of sad; I don't think that's right.

Insurance companies have had some losses, they state, and maybe that's so; but in my particular instance I won't talk in percentages. I'll just talk in dollar bills. We went from $13,000 to $31,000; that's a lot of dollar bills, isn't it? And I don't think that their losses can warrant that kind of increase. I just don't think that those things would wash out.

We've seen what's happened to our medical field all across the country and several other areas where the insurance costs are just skyrocketing. If something is not done about it or they don't get back in line there will be a lot of businesses closing.

I really don't know what's next, what area they're going to hit on next. It just seems like they're going from one to the other, one to the other. You fellows in Washington are trying real hard; you've got a real battle up there trying to control inflation, interest rates, unemployment, and everything else under the Sun, and then we're hit in the face with something like this. It's a pretty big bite to swallow. It is. I always thought that insurance companies were supposed to help people, not hurt them, and I haven't seen their buildings getting any smaller lately.

Thank you very much.

[The prepared statement of Mr. Oakley follows:]

PREPARED STATEMENT OF ALAN D. OAKLEY, PARTNER, WILLARD OAKLEY & SON LUMBER CO., NASHVILLE, TN

Mr. Chairman and members of the committee, I want to thank you for allowing me to testify before you today on the problems that small businesses are facing with insurance costs.

My family has been in the lumber business in Nashville since the early 1940's. I have been actively involved in our company since 1972. In that period we have never had more than a few minor insurance claims and we have never had a workman's compensation claim, knock on wood! In 1983 our renewal premium was $12,240.00. In 1984 our renewal premium was $13,039,00. In 1985 I was presented a bill for $31,808.00.

After getting up off the floor I was told by my agent that I was not the only company to receive such an increase. Since that time I have spoken with several other businesses in the area and found the problem to be very widespread. Mr. Carl Griffis, a roofing contractor, had premiums go from $21,000.00—'84 to $67,000.00—'85. Mr. Lendell Greer at West Nashville Wrecker Service had premiums go from $14,568.00—'84 to $30,246.00—'85. Mr. Jay Dennis, Jr. at Rock Products Insulation Co. had premiums go from $12,700.00—'84 to $22,000.00—'85.

Another local hardware and building materials dealer had premiums go from $32,000.00—'84 to $76,000.00—'85.

The saddest case I encountered was Mrs. Dorris Vernon, a lady that runs a small day care center here in Nashville. She informed me that she has never had an insurance claim in 13 years. Her policy has been canceled completely and she must close her center.

You gentlemen in Washington are trying very hard to control inflation, unemployment, interest rates, etc., and then the insurance companies raise my premium a modest 140%. I thought insurance was designed to help people, not hurt them, and I haven't seen their buildings getting any smaller!

I would like to thank Senator Sasser, Mr. Bill Nourse, and many others for bringing this issue before the committee.

It's nice to know that you care!

Senator SASSER. Thank you, Mr. Oakley. And would you read out again—I want to write it down; you said you made some random telephone calls——

Mr. OAKLEY. Yes, sir.

Senator SASSER [continuing]. To other businesses. Would you read out those businesses?

Mr. OAKLEY. Yes, sir.

I spoke with Mr. Carl Griffis, who is a roofing contractor, Griffis Roofing Co. Do you want me to go over the premiums again?

Senator SASSER. Yes, if you would.

Mr. OAKLEY. His premiums—they gave me a little bit of round figures—his premiums went from $21,000 in 1984 to $67,000 in 1985.

Senator SASSER. This is a roofing contractor?

Mr. OAKLEY. Yes, sir.

Senator SASSER. All right.

Mr. OAKLEY. Mr. Lendell Greer at West Nashville Wrecker Service had his premiums go from $14,568 in 1984 to $30,246 in 1985.

Senator SASSER. A wrecker service—does he haul wrecked cars?

Mr. OAKLEY. Yes, sir; a towing company.

Senator SASSER. A towing company. All right.

Mr. OAKLEY. Mr. Jay Dennis at Rock Products Insulation Co. had premiums go from $12,700 in 1984 to $22,000 in 1985.

I had another local hardware company here that asked that I not use their name——

Senator SASSER. Well, just tell us the premiums.

Mr. OAKLEY. All right, sir. It went from $32,000 in 1984 to $76,000 in 1985, and I can verify that.

Senator SASSER. Did any of these businessmen indicate that they had had some unfavorable loss experience or some great claim against them that would cause this?

Mr. OAKLEY. No, sir. I talked to, pretty much—most of these people I know personally, and this group that I'm referring to here, such as myself, we're not the type of companies that milk the insurance companies for every little nickel and dime. We're companies that have been around a long time, and that's the way to stay in business. And I just don't think it's fair.

Senator SASSER. Now, you say you disagree with Commissioner Neff that this is an isolated instance?

Mr. OAKLEY. Yes, sir; I believe I can start Monday morning and give you a list as long as your leg, if you want me to.

Senator SASSER. Thank you, Mr. Oakley.

Now we're up to you, Mr. Cameron.

STATEMENT OF BILL CAMERON, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, CAMERON OIL, FRANKLIN, TN

Mr. CAMERON. Thank you, Senator Sasser.

My name is Bill Cameron, a petroleum marketer in Franklin, TN. I am here today to seek your help on a problem of extremely serious proportions to me and to my fellow petroleum jobbers across the State, whom I also represent here today. We are small businessmen, each owning his or her own business, marketing petroleum products in our individual territories.

In 1984, for Cameron Oil Co., our total insurance premium for complete coverage was $13,196.75. This was with $500,000 primary coverage and a $4.5 million umbrella, and it included pollution coverage. Our carrier, Fireman's Fund—and I might add that we have never had a claim against this insurance company—for 1984 declined to renew our coverage at any price, so we had to get busy trying to find a company who would write coverage for us. After many, many contacts we finally got coverage through another company with a premium for 1985 of $28,440, the same limits as we had in 1984; however, we do not now have pollution coverage with our present carrier, Ranger. Our premium increased by $15,243.25, over 100 percent increase in premium from 1984 to 1985.

As bad as this is for me, a very small petroleum marketer, some of my fellow marketers are having greater increases than we experienced. One marketer in Knoxville had 1985 premiums for property coverage, workmen's comp, pollution liability, liquor liability and umbrella liability which totalled $68,000. This was a 12-percent increase over his 1984 cost for the same coverage. For 1986 the same carrier, Travelers, who had had this insurance for 5 years, quoted $198,000 for substantially less coverage. This is a 290-percent increase over 1984 and at the same time reducing the umbrella and pollution coverage in half. Another quote was received from another company, Federated, also on lower limits; it was $224,000. Fortunately, my fellow marketer got a third quote from another company for $148,000 with reduced pollution coverage, but the

same umbrella. This was a mere 218 percent increase over his 1984 premium.

Another fellow marketer in Memphis had almost an exact experience in his renewal. His premium for the year 1984-85, complete coverage—multiperil, pollution, workmen's comp, and a $10 million umbrella—was $24,107. The same carrier came back with a renewal for 1985-86 with a premium of $66,280, or an increase in premium of $42,173 without pollution coverage and the umbrella reduced to $5 million. He finally found a carrier who wrote his coverage for a premium of $43,291, the same coverage he had in 1984-85 except that the umbrella is only $5 million. This is an increase in premium of $19,184 in a 1-year period.

Petroleum marketers are not alone in having difficulty in being unable to obtain adequate insurance. I have a friend who has a different type business in Jackson, TN who had complete coverage, including a $10 million umbrella and product liability for a total premium of $47,500. For 1985-86, the premium is $72,477 without product liability and only a $5 million umbrella. The quote for $5 million product liability was $71,400. Needless to tell you, his company did not take the product liability. And incidentally, his company has never had a claim.

I go into these four individual companies to alert you that all small businessmen are in a critical situation, and in our industry in particular the petroleum marketer is in a position where pollution coverage is almost impossible to obtain. If one can find a company or carrier who will write pollution, the cost is prohibitive, forcing many of our petroleum marketers to operate without this coverage. We are well aware that insurance companies were in what we would call a "price war" for a number of years, wanting premiums to invest at high interest rates, charging unrealistic premiums; then suddenly, interest rates drop drastically and claims far exceed premiums. We also understand that premiums should be realistic; however, we do not think the insurance companies should try to recoup all losses in a 1-year period.

This insurance problem is not confined to Tennessee. We just had the National Petroleum Marketers' meeting here in Nashville, 2 weeks ago, and across this Nation people in the petroleum business are complaining about the insurance rates. It seems to be nationwide. Our association, the Tennessee Oil Marketers, has been studying and investigating what could be done to help the petroleum marketer for some time, and we can offer only one solution, one which we hesitate to recommend because we believe private enterprise usually does a better job than Government; however, being in a crisis situation, we see no relief—at least short-term—other than the Government getting involved as they did in 1968 with flood insurance.

If I may, we have one suggestion that we believe would help on a long-term basis. Put a limit on the awards given by the courts. We believe anyone injured should be adequately compensated; however, we see no reason for any award in the hundreds of thousands, even millions, of dollars when in the long run every insured pays and pays dearly for such awards in premiums charged.

I'll be glad to answer any questions, Senator.

[The prepared statement of Mr. Cameron follows:]

PREPARED STATEMENT OF BILL CAMERON, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, CAMERON OIL, FRANKLIN, TN

Senator Sasser and Staff- - - - - -

My name is Bill Cameron, a petroleum marketer in Franklin Tennessee. I am here today to seek your help on a problem of extremely serious proportions to me and to my fellow petroleum jobbers across the State, whom I also represent here today. We are small businessmen, each owning his or her own business, marketing petroleum products in our individual territories.

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for property coverage, workman's comp., pollution liability, liquor liability and umbrella liability totaled $68,000.00. This was a 12% increase over his 1984 cost for the same coverage. For 1986 the same carrier (Travelers) who had had this insurance for 5 years, quoted $198,000.00 for substantially less coverage. This is a 290% increase over 1984 and at the same time reducing the umbrella and pollution coverage in half. Another quote was received from another company (Federated) also on lower limits - it was $224,000.00. Fortunately my fellow marketer got a third quote from another company for $148,000.00 with reduced pollution coverage, but the same umbrella. This was a mere 218% increase over his 1984 premium

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Petroleum Marketers are not alone in having difficulty in being unable to obtain adequate insurance coverage. I have a friend who has a different type business in Jackson, Tennessee who had complete coverage, including a 10 million umbrella and products liability for a total premium of $47,500.00. For 5/85-5/86, the premium is $72,477.00 without products liability and only a 5 million umbrella. The quote for 5 million products liability was $71,400.00. Needless to tell you his company did not take the products liability, and incidently, his company has never had a claim.

I go into these four individual companies to alert you that all small businessmen are in a crisis situation, and our industry in particular, the petroleum marketer is in a position where pollution coverage is almost impossible to obtain and if one can find a company or carrier who will write pollution, the cost is prohibitive forcing many of our petroleum marketers to operate without this coverage.

We are well aware that Insurance companies were in what we would call a "price war" for a number of years, wanting premium to invest at high interest rates, charging unrealistic premiums, then suddenly interest rates drop drastically and claims far exceed premiums. We also understand that premiums should be realistic; however, we do not think the insurance companies should try to recoup all losses in a very short period of time.

Testimony of Bill Cameron before Senator Sasser, November 16, 1985

This insurance problem is not confined to Tennesse and not to our industry alone, it seems to be nationwide for all kinds and types of businesses. Our Association, the Tennessee Oil Marketers, has been studying and investigating what could be done to help the petroleum marketer for sometime and we can offer only one solution. One which we hesitate to recommend because we believe private enterprise usually does a better job than does government, however, being in a crisis situation we see no relief at least short term, other than the government getting involved as they did in 1968 with flood insurance.
If I may, we have one other suggestion that we believe would help on a long term basis - - Put a limit on the awards given by the Courts. We believe anyone injured should be adequately compensated, however, we see no reason for any award in the hundreds of thousands, even in millions, when in the long run, every insured pays and pays dearly for such awards in premiums charged.
I will be glad to try to answer your questions - - - -

Thank you for alloting me this time to present our problem to you.

Senator SASSER. Gentlemen, thank you very much.

Mr. Cameron, one question that comes to mind immediately in your testimony—we heard earlier that one of the real problems and one of the driving forces behind pushing insurance premiums up were awards given in product liability cases. Now, I note here that your friend in Jackson, TN, had almost a 100-percent increase in premiums even though his original policy, which cost him $47,500, had product liability. In the subsequent policy it cost him $72,000, and it did not have product liability.

Mr. CAMERON. He makes radiators for locomotives; he is not even connected with the oil business. But he couldn't get the product liability.

Senator SASSER. So is it your feeling, the feeling of this panel that these premiums are going up exorbitantly, even though product liability is excluded and is not part of the coverage?

Mr. CAMERON. You've said the obvious. Our business was founded by my father in 1922, and I'm sitting down there completely bare, without any sort of pollution controls; we can't get it.

Senator SASSER. Well, let me ask you gentlemen this. Have the insurance companies attempted to explain to any of you why the premiums have gone up so dramatically? What have they told you?

Mr. BOOTH. Well, they told me that in case of pollution matters that, first of all, that the insurance companies nationally suffered losses last year that they had not suffered since the San Francisco earthquake, and they were going to be recouping those losses. They also indicated that because of the claims—awards—that had been made in pollution cases, that a good many of these things were just simply being excluded, that there was no way for insurance companies to determine what the awards were going to be, and therefore they were just going to be excluding those things.

Senator SASSER. Well, gentlemen, let me say this to you. I couldn't agree more with you, Mr. Cameron. We don't want to get Government involved in these matters if they can be handled by private business because we've got more to say Grace over in Government now than we can handle, to be quite frank with you. But do you gentlemen agree that we ought to just let the marketplace correct this capacity crunch, or should we be looking at some sort of interim programs here to try to bridge the gap until a solution can be found in the marketplace?

Mr. OAKLEY. That's a big question. I really don't know what the answer is, and I don't know anybody who does right now. But I think we're on the right step. I think you people caring is a very good start, and just by digging into it a little bit and looking around, it won't hurt anything. It won't hurt anything at all.

Senator SASSER. You think it might get their attention?

Mr. OAKLEY. Yes, sir; I believe you've got their attention. This is across all the small businesses, from the lumber companies to the day-care centers to the oil jobbers, even to a service station operator.

You know, it used to be that you couldn't afford to be without insurance. Now it's getting to be where you can't afford to be with it; there's going to be a lot of people in that boat.

Senator SASSER. Well, gentlemen, I thank you very much for sharing your views. It's been very, very helpful, and, of course, this

will be part of the permanent hearing record, and I appreciate your appearing. I'm glad to see you here. Thank you.

Our next panel, and our last panel today, will consist of Mr. Oran Ward of the Crump Co. here in Nashville; Mr. Bill Van Cleave of Brady, Van Cleave & Williamson in Nashville; and Mr. Eugene Frazer, Jr., the vice president of Shafer Insurance Agency.

Gentlemen, I welcome you here today and I know that those of you who are in the insurance agency or insurance brokerage business are very concerned about what's happening in this field because I've talked to some of you privately about it and have gotten quite a bit of correspondence. I know you're concerned about what's happening to your customers and concerned also of what's happening in the public policy field where we have firms and individuals and companies going either underinsured or with no insurance.

So why don't we lead off with you, Mr. Frazer?

STATEMENT OF EUGENE L. FRAZER, JR., VICE PRESIDENT, SHAFER INSURANCE AGENCY, KNOXVILLE, TN

Mr. FRAZER. Thank you, Senator. I appreciate being asked to appear and testify before this commission.

The areas that are problems in the insurance industry today—in commercial insurance, and it's not just limited to liability; it's all commercial insurance—are price, capacity or availability, and then the area of "claims made" which we'll hear more about in 1986. You'll be getting calls from people in your constituency asking about "claims made" policy, what's the difference.

The price we talked about—why did the price jump so much in 1985? We have talked about the huge credits that the insurance companies gave in the 1980's, and they gave these credits to attract business, to invest the moneys because of the high interest rates. If you take a business that has been operating for 10 years and you go back into the late 1970's, 1978 and 1979, and you take the premiums that they paid for commercial insurance during these years and convert that to a rate based on sales or payroll or values—but compare the premiums to the exposure at that point—and plot that to today's pricing, you're not going to find that the insurance price today will have changed that much in relation to other expenses. It has changed because of the pricing that was given in 1984 and 1983. The insurance companies are trying to recoup the losses as quickly as they can. They are doing it; there's no question about it. You heard testimony on the subject, that there are huge increases. These increases, I think, are behind us, Senator—I think we'll find, in 1986, that the insurance renewals as they come due will not be anywhere near the increases that we saw in 1985. Now, I'm not going to tell you that we are going back to the 1983 and 1984 premiums either, but you're not going to see the big increases that you saw in 1985. This is because the premiums are becoming earned; and as the premiums are becoming earned, it increases the insurance company's surplus. By increasing the surplus, they are in a position to become more competitive. This gives them more capacity.

I think we'll find that the pricing, when viewed over the last 8 or 9 years, really isn't that far out of line. I don't think we're going to see any continuation of these huge increases in pricing.

The second area that we're concerned about is capacity or availability. There's no question that when insurance companies lose a lot of money, as they did in 1984, they're going to cut out insuring risks that present the largest exposure. The testimony that you heard today was in areas that present large exposure. There are a lot of others, too, that we didn't even talk about today—public livery, long-haul trucking, and automobile dealerships are areas of high exposure. They're high exposure because they're dealing in products that affect people. The courts have tended to make very high awards for people injuries, and the courts have tended to find coverage where the underwriters did not intend for coverage to exist, in order to compensate injured people. The insurance companies, because of their "deep pockets," have had to foot the bill. When you get an era like we just went through, where insurance companies are trying to recoup, they're going to create shortages in hazardous areas.

I think, as the premiums become earned and as more capital is put into insurance companies—and we're seeing this through increasing stock prices—the capacity will return. The availability will return. And as that returns, there will be more competition for the business.

The "claims made" policy, which the insurance companies are going to in 1986 because of the attempt to limit the courts interpreting policies to provide coverage where none was intended, will create foreign reinsurers and foreign insurers to come back into the marketplace in this country. I had a telephone conversation Friday with a Canadian agent that I'm acquainted with. He called me because he has a business insured in Canada that exports products to the United States and he just got his renewal policy. The Canadian company is excluding all product claims coming out of the United States. This is because of our court system. The foreign reinsurers and insurers are scared to death of what our court systems are doing. I think this is an area that we really need to get into. Is the tort situation working?

There is an area of capacity that worries me, Senator, and it's in the pollution field. Pollution is a countrywide problem. The Federal Government is involved in pollution right now. The insurance companies are scared to death to try to insure pollution because they don't have any idea of what kinds of liabilities they're opening themselves up to. And as the Federal Government did provide insurance for flood and did provide crime insurance in the past, I think that perhaps they might look into the pollution area.

Outside of that one area, I really think that the marketplace is in the process of correcting itself, and by this time next year I think we will have stable prices and the capacity will create more competition.

Thank you.

[The prepared statement of Mr. Frazer follows:]

PREPARED STATEMENT OF EUGENE L. FRAZER, JR., VICE PRESIDENT, SHAFER INSURANCE AGENCY, KNOXVILLE, TN

THE INSURANCE SITUATION IN THE MARKET PLACE TODAY

Report to Senate Small Business Committee, November 16, 1985

There are 3 major areas of concern about commercial casualty and property insurance that bother business owners today. They are price, capacity (availability), and change from occurance to "claims made" policy for general liability.

In connection with pricing, business owners today are facing huge increases in their casualty and property insurance over what they paid last year. This came about because insurance companies became involved in a price war starting about 1980 and while inflation and interest rates rose higher and higher, insurance cost went lower and lower to a point where many businesses were receiving discounts of 80 to 85 per cent off of the manual rates. This was because insurance companies were able to make so much from their investments (due to high interest rates), that they were willing to give huge discounts to attract new accounts so that they could invest the premium dollars. Insurance premiums were deliberately priced below break even points. This caught up with the insurance companies midway through 1984 and the insurance results in 1984 were so bad the losses exceeded the investment income for almost all of the major companies. This resulted in the insurance underwriters doing two things that caused prices to skyrocket. First, they eliminated the huge discounts going to a modest 20 to 25 per cent credit at most, and manual rates in many circumstances. Secondly, the rating organization that files rates (ISO) had been filing new rates in all lines of insurance on an annual basis during the "soft" market and the new rates were increases over existing rates. Many of

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the insurance companies did not adopt the "new" rates preferring to stay with lower rates to attract new accounts. When the market turned, the insurance companies quickly jumped to the "new" rates.

Whereas the rates today have jumped substantially over last year, if you go back to the 70's and compare your insurance premiums against your exposure (property values, payrolls, sales, etc.) and convert to a rate, you will find that the rates are not out of line when compared to other costs over this period of time. The big rate increases have already occured in 1985 when some rates increased by 50, 100, 200 per cent or more. The rates in 1986 will be higher than for 1985, but unlike 1985, the increase will probably not be more than 20 or 30 per cent.

Capacity or availability of insurance is a much more crucial issue. With the horrible losses in 1984, many insurance companies restricted their writings in the tougher classes of insurance (long haul trucking, automobile dealerships, public livery, malpractice, and errors and omissions insurance). These all involved liability as jury awards skyrocketed in the past 24 months on every kind of human injury. In addition, many insurance companies went bankrupt because of large underwriting losses, foreign reinsurance that folded, or fraudulent schemes by top management.

This dumped a large number of business risks on the market to be picked up by other insurance companies. These "other insurance companies" are renewing their existing accounts at substantially higher premiums and with higher premiums they must set up reserves which come from surplus. This drains the surplus to the point that many insurance companies have had to place a moratorium on all new business. Thereby, comes the capacity problem. Increased capacity

can come about as a result of someone putting more money in surplus (that is, by investing in the insurance company) or by the insurance premium being earned and thereby building up surplus. Assuming that the current pricing will produce an underwriting profit, the insurance companies will have plenty of capacity by the end of next year. It appears that this will happen since we are almost through one year with increased rates and it is expected that rate increase will continue in 1986.

The real capacity problem is in the liability area and this is because of very high jury awards to injured parties plus the "deep pocket" doctrine that juries tend to use to find a way to compensate injured parties for insurance coverage where the underwriters never intended for coverage to exist. There are certain liability coverages that are very difficult to obtain today because of this situation. They are: liquor liability for businesses that sell or dispense liquor, general liability for day care centers (because of the increased awareness of sexual abuse), medical malpractice for doctors, and product liability for manufacturers of products that relate to people. All of these can be solved by legislative action limiting suits and awards.

There is one area where insurance is virtually non-existant if an exposure exist - pollution liability. Effective in 1986, all pollution (including sudden or accidental) will be eliminated from the general liability policy. Because of the unknown liability that can result from pollution, no insurance company is willing to provide coverage where there is a known exposure. Pollution is in the same category as flood and crime. In the past the Federal Government has set up programs to make flood and crime coverage available. Since the Federal Government is already involved in pollution control they could go a step further

and provide pollution liability insurance.

The third area that will bother business people in 1986 will be the switch from occurrence policy to "claims made" policy in the general liability insurance. This is being done by ISO (the rate making and policy formative organization) in response to the broad interpretation courts have made of general liability insurance suits. The classic case is asbestoes where the injured party was first exposed 20 years ago and has just been diagnosed as having cancer. The courts have tended to let injured parties "stack" liability limits during the years that they were exposed even though this enormous liability was never intended by the underwriters. The "claims made" form is designed to pinpoint the policy and the limits that apply by making the policy respond only at the point the claim is made against the insured.

Foreign insurance and reinsurance (i.e. Lloyds) have withdrawn from the U.S. market because of the way our courts have interpreted liability policies resulting in claimants being awarded damages for coverage where coverage was never intended. By implementing the "claims made" liability policy, this will open up much additional capacity for the insuring party.

In conclusion, the price increases in 1985, when viewed as increases over the past 10 years, are not as exorbitant as first thought. The capacity is tight today and will be for much of 1986. However, by this time next year the increased premiums will become earned and the "claims made" liability policies will be in effect which should ease the situation.

There is a void in insurance protection for pollution liability claims. This is an area which the Federal Government should explore and possibly set up a program to cover pollution similar to the program they set up for flood insurance several years ago.

The basic problem of juries awarding huge settlements is a difficult one. Legislation on both a state and federal level is necessary along with major tort reform to ultimately create a stable insurance market place.

Senator SASSER. Mr. Ward.

Mr. WARD. Senator, my name is Oran Ward. I'm president of the Crump Co. here in Nashville, and Mr. Van Cleave and I have a joint statement to make.

Senator SASSER. All right. Well, do you want to let Mr. Van Cleave make his first?

STATEMENT OF WILLIAM VAN CLEAVE, PARTNER, BANDY, VAN CLEAVE & WILLIAMSON, NASHVILLE, TN, ACCOMPANIED BY ORAN WARD, PRESIDENT, THE CRUMP CO., NASHVILLE, TN

Mr. VAN CLEAVE. Mr. Chairman, my name is William Van Cleave. I am a partner of Bandy, Van Cleave & Williamson Agency, a general insurance agency here in Nashville, TN. I'm here today as an independent insurance agent and as a member of the Insurors of Tennessee, which is a trade association representing independent agents throughout the State.

It might be helpful, Mr. Chairman, to give this panel the independent insurance agent's position. Although we are not employees of insurance companies, we are simultaneously members of the insurance industry because we sell insurance products and we also are a procurer of products for the consumer, so we are a representative of the consumer. Consequently, I think we know something of the problems, both for the insurance company and for the consumer.

There are several reasons for these price changes, this upheaval that is taking place now, most of them mentioned today. I want to mention two; both have been mentioned, and I think they are the primary ones.

For the last 5 years, insurance companies have participated in cash flow underwriting; you've heard that from Commissioner Neff, you've heard it from Mr. Frazer, and we've heard it from your own remarks and comments about that. That's real. The insurance industry, in my opinion, really did lose $4 billion in 1984.

Now, I don't have the facts that you possibly have, but when I see local insurance companies terminating employees who have been working there for 15 or 20 years, I know they're in financial trouble. I believe that those facts are true as they have been presented.

In my opinion, the industry is very shortsighted in the price changes that they have made. I might add that our clients have not complained about the price cutting or the underpricing that took place in the past 5 years; we have not had a single complaint in that regard. Probably it's been an overreaction as far as the insurance industry is concerned in trying to recoup their losses.

A point that I think probably is important is the tort system in the country. It's been mentioned several times; anything that I say would be redundant, but I think it is a point that should be reinforced again. I know of an instance where a motel in Florida was held liable for a guest's injuries that occurred when this individual was injured by an automobile driving on a public ocean beach.

Now, the courts have changed the rules on us. The policy was certainly not intended to have been written that way to cover someone that's injured on a public beach, and there are many

other cases that are just as unreasonable, and these other gentlemen on the panel with me can give you horror stories of that nature.

My experience has been that there's a growing attitude in the country for the individual to disclaim any responsibility for his actions. It's pretty much a quote, now, that people say to me often, "I'm hurt; I'm going to sue, and I don't care whose fault it is." Free money; that's what the public is talking about. The consumer isn't really interested in these causes; the consumer is interested in what can be done about it.

I might digress just a little bit and say that with the exception of the specialty lines which you've heard about today, and you have read in the newspapers, that the pricing for our clients is essentially where it was 5 years ago. Now, this will meet with some skepticism, but we've drawn some comparisons on our mainstream clients, and this is true. I'll give you an example.

We just placed an account, a contractor; the price was $95,000. That's a lot of lettuce. One year ago, his price was $34,000. In 1979, his price was $98,000.

Tort law has got to be reformed. I think it must be reassessed. I think the court decrees and assessments are way out of hand. I believe this can be solved by State legislatures, and I hope it is.

Alternative marketing plans, and this is a tough one, may be an answer for some of the lines that are extremely hard to place, such as some of the States have done with day-care and liquor liability. I believe Oklahoma has done something on liquor liability and Maryland on day care. This may be an answer. However, in my opinion, the Tennessee Department of Insurance has done an excellent job in working with insurance companies to try to get voluntary participation in these hard-to-place lines. There are some areas where they have been totally unsuccessful, but in many instances this has been worked out.

I do not agree with some actions of some insurance companies, but I do agree with the free enterprise system. I'm firmly convinced that we must rely on economic laws and not on Government intervention. I think the Motor Carrier Act that was passed several years ago has been a big problem as far as the insurance industry is concerned. It's where the requirement was based that the limits had to be increased over a period of years for people who transported hazardous cargo. I believe the limit now is $5 million, and this was mandated that this had to be increased. This has caused big problems.

I think that I will terminate my remarks on that line except to say that we've had flood programs, we've had Federal crop programs, we've had crime programs. They've been very expensive, and I don't think that they would help in this instance. I think that we need to rely on the economic law, and I think that the situation will correct itself. We do have a problem in the areas of pollution and nuclear liability and things of that nature.

This concludes my remarks, Mr. Chairman; I'd be happy to answer any questions.

[The prepared joint statement of Messrs. Ward and Van Cleave follows:]

Prepared Joint Statement of William Van Cleave and Oran Ward

Mr. Chairman and members of the subcommittee, my name is William Van Cleave. I am a partner of Bandy, Van Cleave and Williamson, a general insurance agency here in Nashville, Tennessee. I'm here today as an independent insurance agent; a member of the Insurors of Tennessee which is a trade association representing independent agents throughout Tennessee.

It may be helpful, Mr. Chairman, to state the position of the independent insurance agent. Although we are not employees of insurance companies, we are simultaneously a member of the insurance industry since we sell insurance products and a representative of the consumer since we search the market for proper coverages. Consequently, we are familiar with the problems of both the consumer and the insurance company.

There are several reasons for the current upheaval in the insurance marketplace, but I believe there are two primary reasons which I want to mention.

For the past five years, the insurance companies engaged in cash flow underwriting which resulted in an extremely soft market. Prices have been depressed because companies sought larger market share regardless of pricing to make overall profits because of high interest rates. The year 1984 stopped all of that with industry investment returns of $17 billion compared to underwriting losses of $21 billion. A $4 billion industry loss put a sudden stop to the soft market, because insurance companies are in the business of risk taking to make money, not to lose money. In my opinion, the industry was very short sighted with extreme product underpricing during this period of time. I might add, however, that none of our clients complained of underpricing when the premiums were reduced from year to year. These record losses have caused premiums to increase dramatically. Probably there has been an over reaction by companies to make up lost ground too quickly.

Uncertain judgements by the courts in tort liability have been another primary factor in insurance costs. I know of an instance where a motel in Florida was held liable for a guest's injuries caused by an automobile being driven on a public ocean beach. The courts have changed the rules, because this certainly was not intended when the liability contract was written. There are many other stories similar to this one that do not appear to be fair or reasonable. This explosion of litigation and liability assessment has contributed greatly to the price increases we are seeing in 1985. My experience has been that there is a growing attitude in this country for the individual to disclaim any responsibility for his actions. It's, "I'm hurt and I'm going to sue regardless of whose fault it is."

The consumer is really not interested in the reasons why costs have escalated. He wants to know what can be done about them.

I believe, first of all, that with the exception of some specialty liability lines now in the news, pricing for our clients is basically where it was five years ago after taking out inflation and growth factors. This statement may meet with skepticism, but we have run price comparisons on Main Street clients and it is true.

Tort law must be reassessed and reformed. Court decrees and jury assessments are often unreasonable. I believe this can be solved by state legislation to adopt tort reforms.

Alternative marketing plans, and this is a tough one, may be established by the states where insurance in unavailable in conventional markets such as is being done in Oklahoma for liquor liability and Maryland for day care coverage. The Tennessee Department of Insurance, in my opinion, is doing a very fine job working with companies to obtain voluntary participation in troubled areas.

I do not agree with some actions of insurance companies, but I believe in the free enterprise system. I'm firmly convinced that economic laws and not government intervention will return sanity to the industry. Federal regulations and federal programs such as flood, crime and crop plans have been very costly in the past and will not be helpful in the present market. Mandate liability limits such as the Motor Carrier Act will increase the problem rather than bring relief to the consumer.

Mr. Chairman, this concludes my remarks. I hope what information I've provided will provide assistance to your subcommittee. I will be happy to answer your questions.

Senator SASSER. Well, gentlemen, thank you very much. I want to first express my deep appreciation to each member of the panel for appearing today. I think it's clear that insurance agents are on the firing line on this issue. You are between a rock and a hard place, caught between your customer that you're trying to serve and the company that you're attempting to write business through. You're losing business due to these premium increases; at least, most agents tell me that. And I'm sure that none of you welcome the fact that the rates are as high as they are. So, I doubly appreciate you being here today.

One of the things that concerns me and one of the reasons we're in the problem that we're in now is this boom-or-bust psychology, that's present in the insurance industry to a large extent. And then, of course, insurance companies are being acquired by conglomerates whose executives know little if anything about the insurance business; they simply seek to use those premium dollars to enhance the earnings of the overall conglomerate over a short period of time, and this just accelerates the problem of boom-or-bust in the insurance industry.

That's where we in Government are called into play. Just as oil prices went up in 1970 with the Arab oil embargo as Mr. Cameron knows, by 200 percent or whatnot—people come to the Government and say that they need some help. They turn to their elected representatives and say that something has to be done. They're doing the same thing now about their insurance premiums, and they make a good case. You heard that here today; small businesses are going bare, uninsured. And that's really a bad public policy, because the public then is not insured in those instances.

Now, there is a distinguished professor at the University of Tennessee named Professor Doderweick [phonetically], the head of the University of Tennessee's Finance Department. He's been analyzing the insurance industry for 30 years. He suggests that it's possible to break the boom-or-bust cycle of the insurance industry that has, in large measure, contributed to the problem that we have here today.

The professor believes that this could be done if the insurance companies used either a dividend or a premium rebate when times are good for insurance companies. He argues that rather than drastically cutting premiums in a limited number of areas, the insurance industry would do well to give an across-the-board rebate when times are good. He believes that this approach would bring some stability to premium rates and would result in, say, more realistic rates.

Now, gentlemen, you're in this business and he's an academician, and you're down where the rubber meets the road. What's your reaction to that?

Mr. WARD. Senator, if I might answer that, I think that would be not unlike what we've been going through. What happens to that individual buyer when he no longer gets his dividend, as an example?

I don't know what all agents have been doing during this period of time, but we have been concentrating—and the association has been telling its members—that the pricing structure that we've had to work with for the last 5 years could not last, and that there was no justification for it; that people who were enjoying those tremendous discounts, and believe me, they were given, would have to look someday toward a change in that pricing prospect. The question was, when? Actually, it took longer this time than it ever has before, and it became much more severe and it happened more quickly. And that's causing a problem. But the main street business that we see, the changes in the premium levels compared to before all this started is not that great. In terms of yesterday's premium or last year's, the percentage increase is horrendous.

Senator SASSER. Does anybody else wish to react to that?

Mr. FRAZER. I'd like to comment, Senator, about the price reductions. The insurance industry has a starting price—its call a manual or book price. In our agency, we sell prices with discounts up to 80 percent of the manual price. That would be the manual price multiplied times 0.20 to come up to the premium. If you change that discount and give a 40-percent credit off of the manual price, you've raised his premium three times. Prices literally did go to nothing during the last 5 years, and I have to agree with Mr. Ward, that's the dividend that's been happening.

I think while in theory, perhaps, Dr. Doderweick's proposition might make sense, I just don't think from a practical standpoint it would come to place. The insurance companies want the business and are willing to discount new business to get it. I just don't think the dividends would solve that desire on their part to attract new business.

The crisis that we have—that we have had, or that we are having—came about because the interest rates went up so high. If the interest rates had not gone up so high, the other side of the coin would be the making of money on the insurance rates themselves. We've always had cycles in this business because the insurance company's expenses are unknown; they're pricing a product where they don't know what their cost is, until somewhere down the road. This is not an exact science, so they can't put an exact price on it. You're going to have some cycles just because of that situation; and we've had those cycles in the past. We've had times

when insurance has increased—nowhere near like they have this year, but likewise we've had times when insurance has decreased, but never reaching the discount that we had in 1984 and 1983. The twofold effect of the high interest rates plus the cycle of making money on insurance, which we came out of in 1979, has created this. Now, if we can control interest rates, then we wouldn't have this problem.

Thank you.

Senator SASSER. There is some controversy on what is the real economic health of the insurance industry. Now, the industry is saying, of course, that they have had underwriting losses for the last 2 years of $34 billion. That's even a lot of money in Washington, DC, and I have read reports claiming that investment income and premiums will not offset this year's losses, Mr. Frazer—you indicated that you were hopeful that the premiums will remain constant and not go up next year—but I have seen reports that indicate that the investment income and premiums are not going to offset this year's underwriting losses, either.

Then on the other hand, you have the General Accounting Office, study of the insurance industry. They conclude that insurers showed a profitability of $300 million just over the underwriting losses last year for the property and casualty insurance industries. And then we have the New York Times, as I indicated earlier, coming along this past week and saying that property and casualty insurors are among the top five best performers on the stock market, registering a 17-percent increase in a 1-month period, and the other multiline insurors posted a 14-percent increase in the same period.

Now, how do you all feel about this business? Are the insurance companies really hurting, or are they just crying wolf?

Mr. WARD. The first thing, I would say that one of the primary reasons for such a rebound in the market price is that insurance company stocks had been depressed substantially for a long period of time. Now, the analysts and the stock market, I believe, think that the corrections that have been made are going to change that picture at some point in time, and therefore they are investing more money in the insurance business. There was over $3 billion in capital raised within the insurance business in 1985 to support the increased premium writings that the companies anticipated. It was capitalized very quickly. So there is a common belief in the investment community that the insurance companies will return to profitability.

But nobody wanted to buy insurance company stocks during this down cycle. It was obvious to each and every one of us that there would be a loss.

Senator SASSER. Anybody else want to respond to that?

Mr. VAN CLEAVE. Senator, I agree with Mr. Ward. I want to comment upon the profitability of the insurance industry, and I will preface my answer by saying that I am suspicious of insurance companies. I make my living off of insurance companies. I've been in the insurance business since 1956, and I'm glad I have a contract so I can hold them to the letter of the contract.

Senator SASSER. I used to represent them when I practiced law, and I share some of your suspicions. [Laughter.]

Mr. VAN CLEAVE. However, giving the rascals their dues, I think that the losses that have occurred are honest. I think that the insurance industry is in trouble. We represent some regional companies that are almost broke that do not accept any risk at all. In other words, they're not writing insurance for anyone. They're almost on the skids. I feel that it's a true picture.

Senator SASSER. Yes, Mr. Frazer? Did you want to have the last word on this?

Mr. FRAZER. Thank you, Senator.

I mentioned that I felt like the huge increases that occurred in 1985 was over, and I feel like 1986—there will be increases, will not be on the same scale that we had in 1985. The premiums are becoming earned; and as they become earned, more of the earned premiums will go into surplus which will help the capacity.

When a renewal is delivered and it's up 200 percent, the insurance company has to wait for that premium to become earned before they can really do anything with it.

The second thing I wanted to say was that so much of the insurance company's expenses are in loss reserves—unpaid claims—and this is an area that's a guesstimate. Just how valid are their reserves? I think a lot of different organizations are looking at the loss reserves and some are saying that the insurance companies are underreserved; and others, are saying that the insurance companies are overreserved. I think maybe some move by the Federal Government, perhaps to control the setting of the reserves, would be appropriate. This is an expense item to the insurance company and they have the control to set the loss reserves.

Senator SASSER. Well, gentlemen, unless you've got something further to add——

Mr. WARD. I just want to make one other statement. I think there have been 31 insolvencies in the insurance business in the last 12 or 13 months. There are some 278 property and casualty insurance companies that are on the NAIC Early Warning List right now. We, in our company, are very, very concerned about insurance company solvency for the future, and it's because of the rate wars that have been going on and the laxity in the underwriting.

Senator SASSER. Rate wars going on and laxity in the underwriting.

Now, I'm going to wind this up with this question. How much of this can be ascribed, in your judgment, to conglomerates buying insurance companies when they really don't have any experience in the insurance business. These conglomerates are buying insurance companies just to get their hands on the premium dollar and then distort underwriting losses that may have existed in the companies prior to the time that they were acquired? Do you see that as a major problem?

Mr. WARD. I think it's a partial basis, yes. We know, during this 5-year cycle, that there have been insurance companies with insurance people managing them that have tried to get out of cash flow underwriting. One large national company I know dropped $600 million in premiums trying to do that, and it got back to the point where if you don't discount the prices, you lose your best accounts.

So the stimulus was there, I'm sure, from the financial wizards to develop the premium income to invest; but those that were managed by insurance people couldn't help but participate.

Senator SASSER. That's exactly what I thought.

Gentlemen, thank you very much for appearing here today. You've been very helpful.

I'll wind up these hearings today simply by saying that we do have a problem on our hands. The question comes, should we sit back and do nothing and just let the market forces solve this problem? Or should we try to fashion some sort of interim remedy, to get us through this crisis until the market corrects itself? Should we take a look at some type of legislation which would tend to diminish the swings that have prevailed in the insurance industry which I fear are being accentuated and accelerated by conglomerates getting into the insurance business and buying out these companies.

But in any case, these field hearings have been very helpful. They have been very informative, and I very much appreciate those who came for giving up their Saturday afternoon to testify. I notice some folks have been listening to the football game back there on the radio so you can get the scores.

Thank you very much. We will keep the record open for an additional 21 days in the event that someone wishes to file an additional statement or amended statement. They can do so by contacting my office here in Nashville at the U.S. Court House Building or my office in Washington, D.C.

Thank you, and these hearings are closed.

[Whereupon, at 3:05 p.m., the committee recessed, to reconvene at the call of the Chair.]

THE COST AND AVAILABILITY OF LIABILITY INSURANCE FOR SMALL BUSINESS

MONDAY, DECEMBER 23, 1985

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Sioux Falls, SD.

The committee met, pursuant to notice, at 10:20 a.m., in the Embassy Room, Downtown Holiday Inn, Sioux Falls, SD, Hon. Larry Pressler (acting chairman of the committee) presiding.

Present: Senator Pressler.

Staff present: Robert M. Wilson, counsel, and Kevin Schieffer, staff of Senator Pressler.

STATEMENT OF HON. LARRY PRESSLER, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA, AND ACTING CHAIRMAN, COMMITTEE ON SMALL BUSINESS

Senator PRESSLER. First of all, I want to thank you all for being here. I know many of you are busy and some have come a great distance, so we'll get right into the program.

There are many things I could speak of to this audience. And as I look, I see many people here who should be introduced and are old friends, and some have driven from even around the Revillo and Milbank area, and some have come from Tripp. And so I appreciate very much you being here.

Let me say that there are many problems facing our State in the agricultural industry, the problems facing small business, and so forth. I'm going to be having meetings on some of those subjects as I go across the State during the next few weeks. But it has occurred to me that the No. 1 consumer problem, probably, of the next 10 years will be insurance costs—which are caused partly by the court and legal costs that our citizens are experiencing, and the large number of lawsuits that are filed. We're a very litigious society. When addressing this issue, however, we must remember there is also the question of the rights of the individual who has a grievance against a city or an individual.

Now, under the McCarran-Ferguson Act of 1945, as amended in 1948, the issue of insurance and liability was left largely to the States. And basically I'm a States' rightist and I'd rather not see the Federal Government get too involved. And I do hope that our State legislatures will be able to address this problem in their coming sessions.

On the other hand, there is a growing demand for Congress to get involved. And there are two bills pending in Congress, one of

which I'm a cosponsor. There is a bill to establish uniform liability laws across the country. Each State now has its own specific standards of evidence, and so forth. And this, for the first time, would begin to establish a uniform system. Now, of course, that flies in the face of States' rights, but it would lower the number of lawsuits, lower some of the costs and help people who have a legitimate claim get a recovery.

There is also a bill in the medical area that would limit punitive damages to $250,000. That is, you could still recover all your medical expenses and your work expenses and your career loss expenses. Many times when citizens read in the paper that somebody has been awarded $5 million for something, the story behind the story is that they probably never get the $5 million. First of all, it's tied up for years in appeals. Second of all, a lot of it goes to attorney fees and court costs.

And so our system of product liability, of public liability, of sovereign immunity, of small businessmen getting insurance, and of individuals getting insurance is on the verge of breakdown. And we, as a society, have to try to address that. I'm one who would rather the Federal Government not get involved in some of these areas. But it may well be with the expansion of interstate commerce with more and more companies operating across borders, it may well be that we're going to have to fundamentally change the McCarran-Ferguson Act of 1945. But that would involve some very fundamental changes in the way the Federal/State relationships work.

Let me say that we have a number of congressional committees looking into this. The Commerce Committee on which I serve will be holding hearings, and we have already voted on the product liability bill. It was a tie vote, meaning that the attempt to set a uniform standard was defeated. That will be brought up again in a different forum. The State attorney generals objected to that measure, and perhaps it was too sweeping a piece of legislation.

This committee today is the Small Business Committee. It is looking into the high price scarcity of liability insurance in terms of its effect on small businessmen. There are a lot of small businessmen whose rates have gone up to 300 and 400 percent. And there are some small businessmen who are not employing people and not carrying out business because of insurance rates. At the same time, we hear the insurance companies say they profits have declined in this area, although there are others who say that some of their investments and some of their practices in the last few years have not been as wise as they could have been.

But the point is, it's the kind of an issue where it is hard to pinpoint a specific culprit. We can talk about our court system and so forth; our court system has become overburdened. People have to wait to get things resolved. It's very, very expensive.

On the other hand, we're the kind of a society that gives a great deal of emphasis to individual rights. There are people who would argue that it's only by going to a lawyer on a contingency fee basis that the average citizen can probably grapple with General Motors, and that the ability to sue a company forces products to be safer and that it forces practices to be safer.

So there are two or three sides to every argument, but I think the No. 1 consumer issue is going to be a way of finding a balance

in this whole thing. And it's going to take activity on the part of the States, on the part of the Federal Government and some court reform, and possibly a way of settling disputes through arbitration or some other way that's not so expensive.

I think I might cite some of the things that have been brought to my attention. We recently did a newsletter in which we had a questionnaire about what people's rates of insurance were doing. And we don't have all those in yet, but we've had a terrific response in terms of people speaking out about this. It's a grassroots issue, and it's a very, very important one. And even car insurance for the individual has gone up immensely.

A major South Dakota bus company has reduced service in part because its insurance premiums increased over 400 percent. In the Black Hills area, loggers and truckers have experienced huge rate increases and in some cases cannot find any insurance at all. Small businesses of all types are faced with the prospect of paying drastically higher premiums, doing without insurance, or even going out of business. Doctors literally are being driven out of business. Cities are being forced to terminate essential services, and consumers have to pay for these insurance price increases through higher product and service costs.

Now, insurance buyers and sellers alike are calling for various types of tort reform or reforms of our court and legal systems; substantive and procedural limitations to recover; tougher standards of proof; disincentives or penalties for bringing frivolous lawsuits; limits on or disclosure of lawyers' fees; elimination of punitive damages; stronger sovereign immunity; protection for governments, and a host of others. I have been a strong advocate of some of those tort reforms, but we have to be very careful in order to avoid depriving victims who certainly deserve just compensation. And also, I might add, the safety factors involved are something that are forced sometimes by strict standards of liability.

Now, there are strong policy arguments on both sides of civil justice reform, but at least it is relatively easy to define and adjust through the legislative process. The other causes mentioned earlier are not as easy to get ahold of. Underwriting and ratemaking practices are a very important part of the picture as well as the economic peculiarities of the industry. We will be addressing some of these issues later in the hearing.

Before we start too far ahead in talking about the causes and suggesting solutions, we should step back and ask a very fundamental question about whether Congress or the Federal Government should even be involved in this issue. The McCarran-Ferguson Act of 1945, and as amended in 1948, delegated to the States regulatory authority over the insurance industry, and it did not provide for Federal oversight or guidance. It has been suggested that we should revise and perhaps amend McCarran-Ferguson and assert a stronger Federal law in insurance regulations.

My basic philosophy has always been to leave these kinds of issues to the States, but this problem seems to be transgressing State borders. Rates no longer appear to be set on a State-by-State basis, and it is unclear to me to what extent they are regulated at all. My sense is that the overall insurance problem is a result of a combination of factors which include past underwriting practices,

tort law problems, and the cyclical nature of the insurance industry.

I think, however, that we are far from reaching any kind of consensus on the significance of these different factors in the overall insurance problem. Forming that consensus is an essential first step before we begin the task of formulating a solution. We hope that the advice of witnesses who have joined us today will help to develop a clearer idea of how to properly address this complex issue. And I serve on the Commerce Committee in the Senate which will be addressing this issue in the earliest days of the new Congress.

Let me also say before beginning this session that I want to introduce the Small Business Committee staffer who is here, Bob Wilson. We welcome you very much.

Mr. WILSON. Thank you.

Senator PRESSLER. Also here is Kevin Schieffer of my staff, who hails from Yankton, SD. He is a part-time law student and on my staff and covers these issues. He will be helping out this morning.

We have a number of witnesses who have come, some a great distance. The first one, David Christensen, is from Sioux Falls. We have had his company, Raven Industries, before the Commerce Committee and he has stated this problem in the past. We will try to move this hearing right along. We will be taking back specific suggestions.

Later this morning after Mr. Christensen we'll have the first panel, which will be Clifton Anderson, a good friend from Aberdeen, SD, speaking on behalf of the Farmers Elevator Association of South Dakota; and Jerry Wheeler, executive director of the South Dakota Truckers Association. Panel 2 will be Bob Miller of the South Dakota Municipal League and Dr. Frank Alvine, who is chairman of the commission on professional liability of the South Dakota State Medical Association. Panel 3 will be Roger Larsen, president of Williams Insurance, and Ms. Susan Walker, the commissioner of the South Dakota Division of Insurance.

We do have some State representatives here, and many people should be introduced. I'll just ask both John Timmer and Bob Weber, both State representatives, just to stand and take a bow, if they would. We welcome you very much here. And everybody in the room should be introduced, but with that, I'm going to call on Dave Christensen to make his opening statement.

STATEMENT OF DAVID CHRISTENSEN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, RAVEN INDUSTRIES, SIOUX FALLS, SD

Mr. CHRISTENSEN. Thank you, Senator. My name is Dave Christensen. I'm president and CEO of Raven Industries here in Sioux Falls. You have my written statement, so I guess I will feel more comfortable if I just talk a little bit extemporaneously.

I'm just going to speak extemporaneously on a few matters that I feel are tremendously critical, particularly to the industry in South Dakota which, before probably 5 years ago, nobody understood the importance of product liability and what it even meant to a particular industry. And today, everybody understands that particular nomenclature.

There is no question that what you've just said in your introductory remarks, Senator, is correct and right on. What we need is to get some action on the particular remarks that you just made. It's not my style and it's really not my belief to come on and ask the Federal Government to help us in all of our problems. I've been involved as CEO at Raven Industries for nearly 15 years and never once have asked the Government to help us out of anything. I'm a free enterpriser. I believe strongly in it, but I only want the right, then, to be able to act and to manage in accordance with what the free enterprise system is.

I think some of the things are being taken completely out of our hands, and this is a prime example. It's one thing to pay an exorbitant price for insurance and another thing to be able to get insurance at all. It might seem natural to condemn the insurance companies and hold them as culprits in this particular situation. I particularly do not hold them as the culprits. I think they've got some problems to deal with. One is the cyclic nature of their business—you know, their premiums will be down here, and then in 5 years they may be up here. My advice to the insurance companies is somehow to try to level that out so that we can deal with that pricing in a much more sensible way rather than just having the peaks and valleys all the time.

But I think the real—the real villain in this particular topic is the judicial system. We in Raven have been involved in some situations which are just—it's beyond belief and it's beyond comprehension as to what it costs to even take something to trial nowadays.

We have to have product liability insurance, particularly for one of our products, which is hot air balloons. We're a $50 million company. Hot air balloons are $2.5 million, or 5 percent of our company; but we must insure our total company, because it's a publicly held company. We have to make sure we have adequate product liability for this one particular product in order to protect the whole company.

We spent time in London this past year. We've been insured by the London people for the last 25 out of 26 years. One year we came stateside and got insurance for our product in the United States, but generally it's been the London market. The London market would not even talk to us this year. And I personally got involved in it, which I never do, but the overall theme and the overall response that was coming back from London to us as a business in the State of South Dakota is, until you get your act together within the United States and straighten out your judicial system, we're not going to price a product for you. And they didn't price the product, and therefore we couldn't get the product.

And it was simply—you know, you can use all the rhetoric and all the examples that you want to use, but I think that that pretty well tells the story up front, that they can't even price the product in order to give somebody like Raven Industries a quote on the insurance. They don't want to do it. It's costing them anywheres from $500,000 to $750,000 to defend a case in court.

We had an example just recently, a case in Florida, where the legal bill on our behalf alone was $800,000. Well, it gets to a point, you know, where do you draw the line on this particular thing? Because we can't price our product without knowing insurance costs.

Heaven only knows that we've got to be able to price our product, and the insurance company has got to be able to price their product.

I think that there is an unhealthy trend in the United States through the liberal courts and the sympathy thing that the juries have. Trial lawyers certainly look to the jury for sympathy settlements. We at Raven believe strongly that those people who have legitimate claims and are entitled to something should get it. And that's what you're struggling with, is how to bring that about without all the excesses.

In a lot of cases we find maybe there is only 35 or 37 percent of the money that is spent in pursuing a lawsuit goes back to the plaintiff anyway. The rest has been in the legal fees. And I can understand why the legal people in Washington don't want to change the laws. There is no question about it, that it's a bonanza for the people in that particular profession.

I don't understand that and I don't appreciate it, and I think those of us that are in the free enterprise sector trying to make a dollar and fight the battle that are out there in the marketplace today just deserve a better shake than that. I could go on and on about the different situations that we're involved with and I'm sure everybody here in this room has an example that they can cite you, Senator. It's a crisis situation, it really is. Even a company like ours is struggling.

I had to go to New York just the other day to try to get insurance. And finally, I got to meet with the president of the United States Aircraft Insurance Group, and he was willing to help us out, but only out of an obligation that he felt our company, having been part of the aircraft industry for 25 years. On that basis they would help us out. I almost hoped he would say no, because I knew what the price of the premium would be when he came back to us, and it's astronomical. But once they've offered that premium price, we—as a public corporation—are almost committed to taking it at that point or we'd have other problems on our hands.

But you talk about 100 and 200 and 300 percent increases. Our corporation, in particular cases, is faced with premiums that are 10 times this large for a third or a fourth of the coverage. So if you take something that's 10 times as large for a third of the coverage, you're talking something that's 30 times the premium cost.

And you try to price it back to the marketplace; it's impossible. The adage that you can price your product and the consumer is going to end up paying for it—that's a ridiculous statement. Those people who say that really don't have the pulse of the situation in what the free American enterprise is telling us. It's a tough world out there. Competition is difficult. And you find a lot of people are just going bare, without insurance.

You really want to try to protect your consumer and do what is right for them. But in the meantime you're competing against somebody who is going bare or running a garage shop-sort of operation, and then you've got even more of a difficult time.

And I'm convinced that the legal people—and I've been told the first terminology that they learn in law school is who has the deepest pockets. It's never been so true as it's been true in the last 5 years as to who has got the deep pockets. And they'll go right down

through the web to find out who is carrying insurance. And you're going to find out that more and more people are going to be paying or they're going to try to structure themselves differently so that in the end the consumer is going to either pay the insurance cost or be left without any protection.

So I urge you and your panel—and I commend you for your stance that you're taking—and I urge you to continue on this cause. It's very worthwhile. It's very critical to the free enterprise system. And we for one would like to see the Senate come to grips with this and come out with something at least to give us some satisfaction that the problem is being dealt with.

Thank you for your time, and we appreciate the opportunity of being here today.

[The prepared statement of Mr. Christensen follows:]

PREPARED STATEMENT OF DAVID CHRISTENSEN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, RAVEN INDUSTRIES, SIOUX FALLS, SD

There is a growing crisis in this country regarding the cost and availabity of liability insurance. This first became apparent quite a few years ago with the increased frequency of medical malpractice suits, and about the same time, massive product liability awards in the machine tool and automobile industries. At that point the problem might not have seemed serious to the small businessman, particularly to small businesses in South Dakota which are far removed from the big industrial centers of Detroit, Cleveland and points East.

Today, small business owners in South Dakota probably realize that there IS a problem, since there is reference to it in the local news media almost daily. What started out affecting mostly big, remote industries, and professional people you probably didn't really know, has now filtered down to the level where almost everyone knows someone personally who has been adversely affected by the chaos in the liability insurance industry.

While the average person on the street may now be aware that there is a problem, there is less understanding as to why it exists and what needs to be done about it. There is a point advocated by some that the insurance companies have brought this upon themselves. During recent years of high interest rates, it was to their advantage to write as much insurance as possible to bring in money which could then be invested at high returns, against some future time when claims would be paid out of that money. When there is a strong effort to sell large amounts of insurance, competition decrees that insurance premiums will be driven as low as possible. The situation rapidly reversed when interest rates quickly dropped to more normal levels, coupled with some large losses in certain industries. The necessity to play "catch-up" necessarily results in

higher premiums. To this extent the insurance companies have contributed to the problem. However, this is not the major reason for the dilemma we face. Those increases, alone, would be expensive, but would be tolerable. The severity of the situation goes beyond that and is clearly related to the vast increase in the number of lawsuits and in the size of the awards handed out.

As our judicial system grows ever more liberal, it has become common practice that if someone is injured for any reason, someone else will be found to pay for it. That "someone else", naturally, is someone with insurance. The amount of awards individuals are receiving goes up constantly, but even more important are the legal costs on both the plaintiffs' and defendants' sides. A study by the Rand Corporation has shown that for every dollar involved in settling a law suit, only 37 cents is awarded to the injured plaintiff, while the opposing attorneys receive the remainder.

Not all lawsuits are, of course, unwarranted. But today many of them ARE frivolous, directed at the wrong party, or simply not valid complaints. As our judicial system now stands, there are few checks and balances to protect the defendant against what are oftentimes "sympathy awards" given by emotional juries who can feel good about what they are doing for the plaintiff, but can't visualize the negative effect of their action as it spreads from insurance company to defendant to customers and to the rest of society.

We at Raven have felt the seriousness of the insurance crisis at several levels. For some of our products the cost of liability insurance has multiplied over and over again and finally has reached the point where it is almost impossible to obtain at any price. For other lines of product liability and for general liability, the situation is not as severe, but even then, the cost of insurance for the coming year has doubled over that of last year. What concerns us most is the ominous trend that we see. Our hot air balloons are highly visible. Any accident, no matter how it was caused, becomes a tempting target for an opportunistic lawyer. But now even our

everyday products are considered suspiciously by underwriters. This trend is being felt in Sioux Falls at the most elementary level when even day care centers cannot obtain insurance.

The unavailability of insurance deserves special comment. Through most of the past 25 years we have obtained our liability coverage from the London market. It is that source which is now most strenously refusing to write new coverage. There is no one who knows the world insurance market like the London insurers. Their message in refusing coverage is that they can't live with our legal practices. Insurance, by its nature, is a calculated risk for the insurance company. With the chaotic legal environment we have in the United States, they can no longer calculate any risk they might undertake. In effect, they are telling us to "shape up" our system or we will have to do without their insurance.

The crisis that we see is not just one of unacceptable cost; it is not even limited to the question of availability of insurance coverage. It goes beyond that to the continued availability of products and services, both ours and those of anyone else who is in business. If products are dropped and services are discontinued, the consumer is the loser. Even short of that extreme, the higher insurance costs which we incur must inevitably be passed on to the consumer, which again is serving him no useful purpose.

We feel that the time has come for a modification in judicial procedures which will, first and foremost, protect the individual who has a legitimate claim, but at the same time cut down on some of the absurd and unjustified types of cases which are becoming common. Of equal importance is a system where justifiable claims can be settled between the injured party and the supplier of products or services in an expeditious manner and bypass the exorbitant legal fees usually involved. Legislation to serve this end has been evolving in the Senate over the last several years. We support such legislation and we encourage the Senate to complete and bring such a bill to the floor in the coming session.

Senator PRESSLER. Well, thank you. Let me say first of all that Jim Winker of your company did a great job in testifying before the Commerce Committee.

I'm not necessarily new to this issue. For about 5 years I've been a cosponsor of the Kasten product liability bill. It has brought the wrath of the trial lawyers upon me. And incidentally, we did invite the Bar Association to testify here today; they've chosen to testify at Rapid City.

Let me say there are corporate lawyers and trial lawyers, and they're organized separately. Trial lawyers are very active politically and they are not supporters of mine. But on the other hand, they're very fine people and we want to hear their point of view, too. But—and I'm not condemning them here—I think we have to identify where the pressure is coming from and we have to think very seriously about legal reform. But that's easier said than done in our country because our Constitution contains provisions for a jury trial, and that was written into the Constitution at a time when the early Americans were very touchy about the British setting up single courts, and so forth. So it was written into the Constitution.

Of course, a lot of the big settlements have been set by juries who think that some insurance company is paying for it and not the general public. So it's a tough one to come to grips with to preserve the rights of an individual who does have a legitimate grievance. But what I want to get at here is that one of the reasons we have to address this is because it results in jobs to the consumer. Now, what does this do to potential problems in the Sioux Falls area, this experience you've had with insurance?

Mr. CHRISTENSEN. I don't think there is any question that eventually the bottom line is it affects jobs, because you can't be competitive in the marketplace and therefore you're not making the amount of product that you should be. You can't add all the insurance costs into the product. A typical hot air balloon system may sell for $16,000. If we are to price the cost of the product liability into the hot air balloon system, we'd have to add on another $8,000 to $10,000. It's that high. So somebody that should be paying maybe $12,000 would be paying $20,000 for a balloon. It's that absurd. And then, of course, you'd end up not selling the amount of product that you should be selling. And it affects jobs; in our case, it could affect our whole company, so we have to properly keep ourselves insured from that standpoint.

I understand the system and I understand juries and the court system, and so forth, but unfortunately there are lawsuits taking place where you'll spend the $750,000 on both sides, both defendant and the plaintiff, and then it's settled on the courthouse steps before it even gets to the jury. Or it may be settled when the jury is in there deliberating. So we've spent $750,000, they spent $750,000, the jury has never even had their chance to act because everybody is schizo in the interim, and so the two sides have paid out the $1.5 million and the jury hasn't even done their job.

Senator PRESSLER. I think one thing should be emphasized. As a general rule, the person suing doesn't get much of the money in the end.

Mr. CHRISTENSEN. About 35 cents on the dollar.

Senator PRESSLER. And that's something—I mean, the argument is always used that we've got to protect the person who has a grievance, and indeed we do; but these big settlements don't get down to who they're supposed to, and that might be something else we should look at.

Now, in another area: Do our product liability laws and other problems in the legal system place U.S. companies at a competitive disadvantage in international markets?

Mr. CHRISTENSEN. Well, of course, we're no huge factor internationally, but we do see some hot air balloons sold on an international scale. One of our biggest competitors is from Europe and is coming into this country and doing more and more business. I think that there is no question that the product liability issue would affect you in the international market. And I'll let it go at that.

Senator PRESSLER. Have you had any experience with what you consider frivolous lawsuits as opposed to legitimate ones? I know in some countries, if you bring a lawsuit against someone and the judge feels it's frivolous, you might end up paying the attorneys on both sides. And sometimes lawsuits are brought for reasons other than to recover. Have you ever had experiences in this area?

Mr. CHRISTENSEN. I think so, although my terminology of frivolous versus somebody else's may not be the same. But I think that there is an example—I've seen cases settled out of the court, after spending huge sums of money, that I thought were frivolous to begin with. And that frivolous term may apply when they sock you for punitive damages which the product liability end of it doesn't even cover. Well, any good trial lawyer is going to throw the punitive damages thing at you because it's a great negotiating tactic and you also have that fear hanging over you that somebody may decide that you're punitively liable for a particular thing. So you're always negotiating around that particular aspect.

Senator PRESSLER. Would you be troubled—you, like many of us, want State rights and the State activities. Would you be troubled if Congress passed a national product liability law establishing some kind of uniform standards, and even if Congress passed some kind of a cap on punitive damages?

Mr. CHRISTENSEN. I would not be troubled at all. I'd think it would be excellent—a step in the right direction, because there are great inconsistencies. You hate to go to trial in the State of Florida; you hate to go to trial in the State of California. I'd rather go to trial in the State of South Dakota, for instance, being a South Dakota-based corporation. So to answer your question directly, no; I would support it.

Senator PRESSLER. I think it should be emphasized that South Dakota, in some cases, is inheriting the sins of New Jersey and California. When you're forum-shopping for a lawsuit, if you're dealing with a company that does interstate commerce, you'll try to move the trial to a State that has very high payments. And let me also emphasize that many of these suits don't go to trial. If there is a precedent set, a businessman or a board of directors may take a look at it and say it's cheaper to pay off than it is to fight this thing if we've got less than a 70 percent chance of winning.

Dave, I thank you very much.

Mr. CHRISTENSEN. We have people here today. Jim Winker is here in the audience, along with Mark West.

Senator PRESSLER. Let me say, he did a great job when he appeared before the Commerce Committee in Washington.

Mr. CHRISTENSEN. Thank you very much.

Senator PRESSLER. Next, I'll call our first panel, Clifton Anderson and Jerry Wheeler, if they would come forward. And we thank you, Clifton, for coming down from Aberdeen. Clifton is the Secretary of the Farmers Elevator Association of South Dakota. And Jerry Wheeler comes to Washington regularly, and we welcome you here.

And maybe we'll hear from Cliff first, if that's agreeable, and you may summarize your statements if you want. Your entire statement will be in the record. And pull the microphone close so we'll hear you. You almost have to move that right up to you. Bob, maybe you can help with the microphone. Just put them right in front of you. You have to struggle with it there a little bit.

STATEMENT OF CLIFTON C. ANDERSON, SECRETARY, FARMERS ELEVATOR ASSOCIATION OF SOUTH DAKOTA, ABERDEEN, SD

Mr. ANDERSON. Senator, staff members, legislators, and ladies and gentlemen. I would first like to commend——

Senator PRESSLER. I can't quite hear for some reason. That's the live one.

Mr. ANDERSON. I would first like to commend Senator Pressler on his overall review of the problem, and to say the same thing for Mr. Christensen. I think you've both stated the problem very fairly and it eliminates the need for some of my comments. I'd—I'm afraid that what I'm going to say isn't good news for these people who come here concerned about insurance costs, but there is every indication that 1986, I think, is going to be a far worse year than 1985, that people who know are predicting that this crunch may go on for 5 years at the very least.

One reinsurer has made the statement publicly, and I've reproduced it in here, that—that 1986 is going to make this last year look like a cream puff. Far worse than the rocketing prices of this insurance is the fact that one class of insurance after another has virtually gone off the market. And to just come along and say that we can come up with some easy solution just isn't any Band-Aid that's going to solve this problem; it's going to take drastic action.

I certainly am not one that claims they want Federal intervention or anything of that kind, but there may be some things that cannot be solved any other way. And I think we're in the midst of a situation, which the popular thing nationally and Statewise has been deregulation of everything from the airlines to the trucking industry to the insurance business. And I think that there is a great deal of evidence that the people who were deregulated really didn't wisely use their new freedom.

I don't think it's necessary for me to recite all these horrible examples. I've included one little one in here; it's a manufacturing company. In May of this year they renewed their insurance with a company which since became insolvent. Their product liability at that point cost $2,100. When this insolvency occurred they had to

replace that insurance—or had to try—because it evaporated. And the only quote they've—the two quotes they've been able to get, one of them is $35,000 minimum premium, and it would start from there. They don't know how high it would go. And besides that, there would be a $25,000 per-claim deductible. And the company who gave this quote said, "Now, you go back and ask them if they're interested in having us go any further," and so far they haven't indicated whether they were or not.

I think the insurance industry has gotten a lot of bad press and I think it's easy to point your finger at some imprudent things that were done—price cutting, cash flow underwriting—but in defense of the industry, at least the customer got the benefit of this. And I think the—stand by the consumer. They've been getting insurance maybe for half or even 30 percent of what it should have been. Now, when somebody comes along and recognizes the problem and tries to restate this thing to get it back to where they—it should have been in the beginning, you're talking about a 250- or 300-percent increase. So I think you have to recognize that.

Another thing that I'm a lot more familiar with now than I was a while ago, and that is these insolvencies, and for the benefit of the public in each State, are protected by a guarantee fund. And we've just been through one in Iowa which wrote a lot of business in South Dakota. This triggers—an insolvency of this kind—triggers a State guarantee fund who assesses even those companies in the State that have been doing a credible underwriting thing and they make them pay for the losses of the person they never had the premium from in the beginning, and the remaining companies have got to pass that along to the public. So the public isn't benefiting by that.

Now, this reinsurance thing, I think, is the crux of this whole thing. And when you see headlines that say it's the worse crunch reinsurers have ever seen, this has gone back—I've been connected with this business for 50 years. And you're seeing reinsurers going out of the market completely. Lloyds of London are, as Mr. Christensen said—they've publicly stated that the United States judicial system has run amuck. And this article deals with one statement after another of reinsurers who say they want nothing whatever to do with the United States casualty market. Well, that's just bad news.

Even giant companies can't write product liability exposures. They can't write directors' and officers' liability, which is going to be a concern of the banking industry. They can't write professional liability insurance. There is just a lot of catastrophic exposures that they can't write without good reinsurance. And it's not available now.

And I would have to support Mr. Christensen's statement that, as I said in my statement here:

> In conclusion, it's fair to say the major contributor to the crisis is the acknowledged fact that there is more litigation and higher jury awards than ever before. We live in a society which turns to the courts with increasing frequency. There seems to be a public consensus that liability insurance should be the means of guaranteeing social and economic well-being rather than just insuring somebody's legal liability.

And I just feel that tort reform of some sort has to be perfected or these reinsurance—reinsurers are not going to come back into the market at all. Thank you.

[The prepared statement of Mr. Anderson follows:]

Prepared Statement of Clifton C. Anderson, Secretary, Farmers Elevator Association of South Dakota, Aberdeen, SD

There is no question but that drastic increases in Liability insurance premiums are making themselves felt in South Dakota, at all levels in the insurance marketplace. Worse yet, some types of business that are deemed susceptible to catastrophic losses are rapidly becoming impossible to obtain at any cost. EVERY INDICATION IS THAT 1986 "WILL MAKE LAST YEAR LOOK LIKE A CREAM PUFF", according to a leading reinsuror. What we are seeing today is just the tip of the iceberg. "Although insurance capacity has been falling throughout 1985, the unprecedented drop in available will occur with Jan. 1 reinsurance contract renewals, the most popular contract renewal date". (See Business Insurance lead story 9/23/85)

To illustrate what is happening, let me cite some examples, involving both the public and the private sector:

1. Most dramatic, perhaps, was the non-renewal of the Vehicle Liability coverage for the State of South Dakota. It is apparently believed that South Dakota can invoke its Sovereign Immunity as a defense. Private sector businesses cannot solve their exposures this way!

2. The N. E. South Dakota Community Action Program (Head Start Program) lost its auto liability coverage, which forced an early suspension of operations prior to the usual holiday vacation. They are presently seeking an alternate carrier.

3. Agri-Business interests were shocked by the decision of a major insuror of Minnesota and South Dakota agri-businesses, to totally withdraw from the liability and workmen's compensation insurance of any agri-business. This shifts an additional burden to those remaining in this market.

4. An Iowa insuror, reputed to be covering 70% to 80% of Iowa grain elevators, has been been placed under the control Iowa Insurance Dep't rehabilitators. This is an action which normally precedes an effort to find a solvent buyer, or total liquidation.

5. In this climate of market-crisis, here are the actual renewal quotations one South Dakota country elevator is considering. Percentage-wise here are the increases being faced:

General Liability -- up	140%	Vehicle Insurance -- up	30%
Workers Compensation-up	35%	Umbrella Liab. -- up	78%
Property Insurance --up	15%		

(This constitutes a $18,000 increase--primarily on liabillty coverages.)

6. PRODUCT LIABILITY, particularly for small and medium manufacturers is virtually impossible to maintain. Take the case of a local (S. Dak.) firm, whose products Coverage on a May 1985 renewal was $2,100. This was with a firm which became insolvent and had to be replaced November 9th. Only two potential carriers have been located. One of these is itself a "B" rated company. They have indicated prior to consideration, that they would impose a $35,000 Minimum Premium, with a $25,000 per claim deductible. Another says it would take 6 to 8 weeks to quote, that there would be at least a $25,000 Min. Premium with a $15,000 to $20,000 per claim deductible.

In addition to the basic liability products coverage, this company had a $1,000,000 Umbrella with a $7,800 premium covering their total liability exposure. This is not renewable at any cost, until they have first procured the underlying products coverage.

IT IS EASY TO SINGLE OUT CERTAIN KNOWN FACTS, AND POINT THE FINGER AT CERTAIN ASPECTS OF THE INSURANCE/INDUSTRY -- BUT NO SINGLE, SIMPLE APPROACH IS GOING TO ILLEVIATE THE PROBLEM. I cite the following as contributors to what has been termed "THE WORST CAPACITY CRUNCH IN HISTORY", as follows:

A. It is true that insurors generally were imprudent in pursuit of "cash flow", to the extent that they were willing to tolerate underwriting losses in return for the investment income these premiums made possible. When high interest rates evaporated, they experienced staggering losses, and in some cases total insolvency ensued. FROM THE STANDPOINT OF THE INSURED, THE PUBLIC HAS BEEN THE BENEFICIARY OF BARGAIN-BASEMENT INSURANCE PRICES.

B. When insurance company insolvencies occur, they trigger the assessment of solvent insurors by state guarantee funds. This has a"domino"effect by imposing the results of bad management and poor underwriting on those who least deserve, and forces the surviving insurors to pass on Guaranty Fund assessment costs to their own policyholders, or face insolvency themselves. "Fears of more insurance company insolvencies are prompting concern that the current state guarantee fund system won't hold up under increasing demands."(See Business Insurance 12/9/85 photocopy.)

C. Catastrophic Losses, particularly in the Liability Market, have become an ever present threat which even giant insurance carriers must cushion through the purchase of reinsurance. If it is available at all, its cost must be built into every insurance contract. It is an acknowledged fact that no one wants N. American Casualty market reinsurance, and Lloyds are reported to have withdrawn from the U. S. Casualty market completely with the observation that "the U. S. Judicial system has run amuck!"

To sum this all up under these conditions there is a reasonable expectation that availability of limits in 1986 will be drastically less then in 1985. The only solution is for the american insurance industry and its potential reinsurors to achieve profitability. THIS INVOLVES RAISING RATES TO WHATEVER LEVEL IT TAKES TO ASSURE PROFITABILITY AND RECOVER GUARANTEE FUND ASSESSMENTS FOR OTHERS. THIS MAY BE BRUTAL!

IN CONCLUSION, IT IS FAIR TO SAY THAT A MAJOR CONTRIBUTOR TO THE CRISIS IS THE ACKNOWLEDGED FACT THAT <u>THERE IS MORE LITIGATION AND HIGHER JURY AWARDS THAN EVER BEFORE</u>. We live in a society which turns to the courts with increasing frequency. In addition there seems to be a public concensus that liability insurance should be the means of guaranteeing social and economic well being--not simply the strict liability of the insured. New and expanding legal theories, a more sophisticate plaintiff's bar, and a proliferation of catastrophic judgements have obviously driven both foreign and domestic reinsurors from the American market. Tort reform appears to be the only thing that will bring them back.

Worst crunch

Reinsurers worldwide cut limits

MONTE CARLO, Monaco—The worldwide reinsurance [redacted] the worst capacity crunch in history.

Corporations, which already have seen the amount of insurance [redacted] be drastically less than in 1985.

And, what insurance is available will be more expensive.

[redacted] the impending crunch, reinsurers [redacted] they will write [redacted] and for each other. And [redacted] the insurers have been driven out of business by losses.

Hardest hit is casualty business, where retrocessional capacity could plummet as much as 75%.

Contributing to the capacity cuts for U.S. casualty business is the decision by many Continental European reinsurers to stop writing U.S. casualty risks.

The result will be a worldwide marketplace in which it will be more difficult to place business than during the mid-1970s or in 1967-68 following Hurricane Betsy, which to date were considered the worst insurance marketplaces.

And, this capacity-tight marketplace could last from three to five years.

These are the assessments of the reinsurance company executives and reinsurance brokers who gathered in Monte Carlo earlier this month for the 29th annual Rendez-Vous de Septembre, the largest international [redacted] the reinsurance business.

Attended [redacted] Rendez-Vous meet with their colleagues and business partners in hotel lobbies and private suites, in outdoor restaurants and in cafes to discuss the state of their current business ventures and to gauge future opportunities.

The Rendez-Vous provides the first soundings of what's in store for the insurance and reinsurance market in the year ahead.

"This year is going to be brutal," says one U.S. reinsurance executive, echoing the thoughts of most of the more than 2,000 registrants from 81 countries at the conference, held Sept. 9-12.

"This year will go [redacted] down as a cream puff," says [redacted] chairman and president of reinsurance intermediary John Gilbert Intermediary Group in New York.

"No one wants [redacted] Nearly everyone was running late for appointments, either because they were overambitious in scheduling meetings in an effort to corral all the potential capacity they could or because many meetings ran longer than anticipated because of much more serious discussions.

In addition, reinsurers and brokers noted that, for the first time, they were scheduling meetings on Friday, traditionally the day everyone packs up to head home.

Although insurance capacity has been falling throughout 1985, the unprecedented drop in available insurance will occur with Jan. 1 reinsurance contract renewals, the most popular contract renewal date. Insurers will [redacted]

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This report was written by Editor Kathryn J. McIntyre and London Editor Stacy Shapiro, who attended the Rendez-Vous de Septembre.

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Guaranty funds levy record charges

By STEVE TARAVELLA

LOS ANGELES—Property/casualty insurers are forking over record assessments this year to state guaranty funds to pay policyholders' claims against a rash of insolvent property/casualty insurers.

California and Florida alone are assessing insurers licensed in their states $85 million this year—the amount insurers were assessed by all states in the previous record year, 1981.

Assessments in three other states that know they will levy large assessments this year bring the 1985 assessment in just five states to $118.5 million (see chart).

And in one of those states—Florida—insurers have already paid the maximum assessment permitted in one year in three of its four claim assessment categories.

State guaranty funds respond to policyholder claims against insolvent insurers licensed in their state, generally capping claim payments to a maximum amount. Workers compensation claim payments, however, usually are not capped.

Licensed insurers in each state are assessed the money as needed to cover the guaranty fund claim payments, with assessments capped at 1% to 2% of an insurer's net direct written premiums in the previous year.

Only New York state prefunds its guaranty fund liabilities.

States levying large assessments

State	Gross assessments 1985	Gross assessments 1984	Net assessments 1969-84	Maximum payment per claim
California	$85 million	0	$100 million	$800,000
Florida	$30 million	$42 million	$117 million	$300,000
Maryland	$13 million	0	$2.8 million	Unlimited
Georgia	$10.5 million	0	$3.2 million	$100,000
Illinois	$10 million*	$5.9 million	$20 million	$150,000

*Estimate

Chart: Amy Palmer

[redacted] charges, or [redacted] profits.

Assessments to cover guaranty fund claim payments exploded last year, when insurers were assessed $74.1 million by all property/casualty guaranty funds—nearly 15% of the total $527.8 million in gross assessments made by guaranty funds from the first fund formations in 1969 and the early 1970s to year-end 1984.

(Insurers' net assessments through 1984 total $393.2 million, since $.34.6 million was refunded from proceeds of the sale of insolvant companies' assets and excess funds when loss projections were overestimated.)

The huge assessments in 1984 and 1985 were needed to cover a two-year rash of insurance company insolvencies, including some large insolvencies such as Ideal Mutual Insurance Co. and more recently Union Indemnity Insurance Co.

Twenty property/casualty insurers were declared insolvent in 1984, tying the previous record in 1975 of 20 insolvencies.

So far this year, 18 property/casualty insurers have gone broke, according to Richard J. Marcus, executive secretary of the Schaumburg, Ill.-based National Committee on Insurance Guaranty Funds, which monitors property/casualty guaranty funds.

But, Mr. Marcus cautions that this number is preliminary: Although 1984 insolvencies totaled 20, at this time last year, NCIGF tallied only 14 or 16 insolvencies.

Not tallied by NCIGF, for example, are the insolvencies of Mission Insurance Co. and Transit Casualty Co.

While Mission may be rescued to prevent calls on guaranty funds (*BI*, Dec.2), Transit Casualty was placed into liquidation last week by the Missouri Insurance Department. The liquidation order against Transit triggers the remaining state guaranty funds around the country that respond only [redacted] pany is placed in liquidation [redacted] funds begin paying claims when [redacted] declared insolvent.

"The heavens just opened up and dumped on us," one guaranty fund director says of the past two years. [redacted] insolvencies [redacted] increasing demands.

The National Assn. of Insurance Commissioners meeting this week is expected to consider a proposal to exclude from guaranty fund coverage policyholders of a certain size and specific types of insurance, such as directors and officers liability insurance and fi-

Continued on page 39

Guaranty funds

Continued from page 1

nancial guarantee policies (*BI*, Nov 25).

The proposal before the NAIC would deny policyholders whose net worth exceeds $10 million access to the funds for recovery of first-party claims.

The new restrictions on guaranty fund coverage are designed to lessen the burden on surviving insurers and protect the funds from running out of their assessment authority to cover claims against insolvent insurers.

Last year, for example, the Hawaii Insurance Guaranty Assn. assessed its maximum of 2% of net direct written premiums, assessing a total of $10.6 million. The amount covered claims payments.

This year, Hawaii has assessed only 1% to collect $6.5 million, according to Clifford House, the fund's administrator.

Assessments this year in other states that historically have levied the largest assessments to fill the coffers of their guaranty funds show why insurers are concerned.

The California Insurance Guarantee Assn. expects to assess insurers $55 million this year, more than ever before, according to John Gates, the fund's executive director in Los Angeles.

The Florida Insurance Guaranty Assn., one of the large[illegible]in total payments since its inception, has assessed its licensed insurers the maximum allowable—1% of net direct written premium—in three of its four claim assessment categories.

Florida has assessed the maximum allowed this year to cover workers compensation, auto liability and auto physical damage claims. Only its "all other" category is permitted more assessments.

In previous years, Florida has levied the 1% maximum in one or two categories, but not in three, reports P.J. Meunier III, the fund's manager in Jacksonville.

'. . .We're paying for bad management and poor underwriting practices,' says Mr. Gates.

The $30 million assessment this year against Florida's 450 licensed insurers will enable the fund to pay policyholders an estimated $50 million, up from $14 million last year, Mr. Meunier says.

The 1985 assessments in Florida will cover claims payments, but if the assessments were to fall short, the fund could borrow money from licensed insurers, borrow money from banks or seek advance payments from the receivers of insolvent companies.

The smaller assessment in 1985 than the $42 million assessed in Florida in 1984 was made possible by interest on loss reserves and proceeds from the sale of assets of other insolvent companies.

The fund is now paying claims on 20 insolvencies, 12 of which occurred in the last two years.

The Maryland Insurance Guaranty Assn. will assess insurers about $13 million this year; it asked for nothing in either 1984 or 1983, according to Joseph R. Petr, executive director and counsel.

"This year, they're coming in heavy," Mr. Petr says of insurer insolvencies.

Maryland's is the only fund that does not cap claim payments, but Maryland's Legislature is considering a bill proposed by the state Insurance Department that would cap payouts at $300,000.

Claims for surety losses would be excluded under the proposal. Maryland's is one of less than a dozen funds that respond to surety losses.

The Georgia Insurers Insolvency Pool has collected $10.5 million this year to cover eight insolvencies—after three years during which the state's 450 licensed insurers were spared any assessments.

The Georgia fund will pay policyholders an estimated $3 million this year—nearly the $3.4 million it paid out during the 14 years between 1970 and 1984.

Unfortunately, Georgia "hit the jackpot this last year," notes Percy Marchman, administrator of the fund.

Georgia's guaranty fund now pays out up to $100,000 per claim. That is up from the $50,000 per-claim cap it applied prior to July 1.

Illinois might assess its 700 insurers an estimated $10 million this year, up from about $5.9 million last year, says James Stevenson III, manager of the Illinois Insurance Guaranty Fund in Chicago.

Pennsylvania, which ranks third among all states in assessments through 1984, will determine the 1985 assessment within the next few weeks. Officials there were unable to predict what the figure might be, but it is expected to be significant.

Through 1984, the Pennsylvania Insurance Guaranty Assn. assessed insurers $25.9 million.

Guaranty funds are preparing for more activity next year.

"All indications are that insolvencies will continue. Nineteen eighty-six looks like a bad year," observes Florida's Mr. Meunier.

Two months ago, directors of Florida's fund adopted contingency plans designed to keep the fund properly staffed if several major insolvencies were to strike simultaneously, reports Mr. Meunier.

Additional insurance company insolvencies in 1986 would certainly increase demands on guaranty funds, but guaranty fund managers do not appear concerned that their funds will not be able to meet demands.

Assessments are based on premiums written in the previous year, and premiums this year rose swiftly on the strength of big rate hikes. As a result, guaranty funds in 1986 will have access to an even larger premium base than they do this year.

Concern that guaranty fund assessments could drive surviving insurers into insolvency, too, may be unfounded.

Insurers can pass on the cost of guaranty fund assessments to their policyholders.

And, if an insurer can show that paying a guaranty fund assessment would impair its financial strength, the guaranty fund could excuse the company from its obligation, notes NCIGF's Mr. Marcus.

Nonetheless, insurance companies would like to see less guaranty fund activity.

"They've never liked the idea of being assessed to pay for the insolvencies of their competitors. The more they're assessed, the less they like it, so now that assessments are up, they like it even less," says Phillip Schwartz, vp-financial reporting at the American Insurance Assn. in New York.

"From a cold business standpoint, we're paying for bad management and poor underwriting practices," observes California's Mr. Gates.

Georgia's Mr. Marchman says that state's guaranty fund tries a positive approach. "The better job we do in the insolvency, the better the image will be of the insurance industry, which is already bad," he suggests.

While guaranty fund assessments aren't welcomed by insurers, few policyholders turning to the funds have complaints.

"I'm generally impressed with the way the various state guaranty funds have taken over," reports Thomas A. Duffield, vp-insurance and risk management at Archer-Daniels-Midland Co. Inc. in Decatur, Ill. Numerous state funds are now handling ADM's workers compensation claims since Ideal Mutual Insurance Co. was placed in liquidation by the New York Insurance Department early this year (*BI*, Jan. 14; Feb. 11).

Ideal Mutual had acted as a fronting insurer for ADM, reinsuring ADM's workers compensation business with ADM's Cayman Islands-based captive insurer. ■

New York's fund unique

While guaranty funds in most states are levying record assessments to cover claims against insolvent insurers, New York's guaranty fund is paying claims with money collected more than 10 years ago.

New York's Property/Casualty Insurance Security Fund is the only property/casualty guaranty fund in the country that prefunds for its liabilities. New York maintains at least a $150 million balance in its fund.

New York last assessed licensed insurers in 1973, when it collected $15 million to [illegible]0 million, says Frank D'Amico, director of taxes and accounts in Albany.

Anytime the fund falls below $150 million, licensed insurers are assessed 0.5% of net direct written premiums during the previous year.

With $180 million on hand now, New York's fund does not expect to make a new assessment for at least another year.

For the 12 months ending March 1, 1985, New York's fund had paid out $21.5 million.

New Jersey's guaranty fund originally also was pre-funded, but it switched to its current post-assessment method in 1974.

Senator PRESSLER. Thank you very much.

Jerry, why don't you give your statement?

Mr. WHEELER. OK.

Senator PRESSLER. Pull those microphones closer. You know it is since you're a veteran witness in the State legislature as well as at the Federal level.

STATEMENT OF JERRY WHEELER, EXECUTIVE DIRECTOR, SOUTH DAKOTA TRUCKERS ASSOCIATION

Mr. WHEELER. I don't know how veteran I am, but I know that we do have some bad problems here and I thank you, Senator Pressler and Kevin, for coming out to South Dakota to help as best you can to solve some of these situations.

First of all, my name is Jerry Wheeler and I am the executive director of the South Dakota Trucking Association. Our organization represents 554 members of the trucking industry in South Dakota. Trucking companies have been especially hard hit by the national insurance crisis that is gripping our country.

One thing that is extremely unique about our industry is the fact that State and Federal Governments, dictate the levels of insurance coverage that our members must carry. On the other hand, insurance companies are refusing to write coverage altogether in some cases, and pricing it totally out of reach in others. We are caught between trying to comply with laws that say what coverage we must have versus not physically being able to do it.

I would like to review some of the problems that our industry has experienced during the past year. I know, Senator Pressler, that you've been very helpful in the past, but our premium rates for primary coverage for public liability and property damages for general commodity carriers have skyrocketed on the average from 250 to 500 percent with no apparent connection—and this is one of the things that bothers me—with no apparent connection to the safety experience of the insureds. Carriers tell us of claim-free records, which have had no effect on the level of the rates being quoted to them.

Some carriers have been unable to get coverage at any rate, especially the tank truck carriers hauling hazardous material. We've been told of tank truck carriers—and we've lost one of our major carriers here in South Dakota, Dan Dugan Transport, who just went out of business—that have gotten increases in the 1,000-percent range. I don't care what kind of a businessman you are; you can't absorb that type of an increase.

We've also been told that effective January 1, 1986, these types of operators—those that are hauling motor fuels, hazardous materials of that sort—will not be able to buy what we call environmental restoration insurance at any price. I don't know what that means. I don't know if that means that these people are just going to have to simply quit hauling, or if they're going to have to say, "The most I could lose would be my company," and keep hauling, or just what's going to happen. But we do have a crunch there.

Primary coverage premium rates for cargo loss and damage liability have risen on the average of 70 to 150 percent. We also know that many carriers have doubled and tripled their deducti-

bles trying to ease the premium increase. But this, too, can catch up to a company that's operating on a marginal basis if they do have claims and have their deductibles placed too high. It's essentially either going to severely cramp their style or it's going to put them out of business.

Many companies, like I said, just simply can't get insurance at all. It's one thing to be able to get it at a higher price, but it's something else if you just can't get it. Some insurance companies are arbitrarily canceling policy coverages midterm and some are canceling without prior notice.

We had some firsthand experience right here in our State. Our association had approximately 200 small trucking companies; I'm talking about one, and two-truck operators up to five, and six-truck operators; that we had a workmen's compensation insurance program for. A company by the name of Rockwood Insurance that was carrying the insurance. All of a sudden our members started calling in saying, "We got our worker's comp canceled; do you know anything about it?" And we said, "No, we don't."

Well, we investigated and found out that this company had just—midterm—sent out cancellation notices to all of our enrolled members. With the help of South Dakota Insurance Commissioner Susan Walker and the State, we were able to get these policies reinstated until their natural expiration dates. As these policies now expire, all of the previously enrolled carriers will either be forced to find coverage elsewhere or join South Dakota's assigned risk pool, which will cause more problems for the State.

We checked with some 20 insurance companies, and the statistics that we had were that our carriers were doing approximately $1 million in premiums. We had about $600,000 a year in claims, and could not find any carrier that would even talk to us about writing that insurance. We couldn't even get them to say hello.

It's a situation where, like I said earlier, I think you can look at the legal profession and our court system but I think that the insurance industry is not clear of sin in this area, either. I think there are some problems there.

Just to demonstrate how bad the problem is, our national association, the American Trucking Associations [ATA], set up a hot line to help carriers try to place their insurance. They have been receiving a thousand calls a month with carriers trying to find an insurance company. ATA went to the Interstate Commerce Commission, talked to them about the problem; they gave us a list of 700 underwriters the agency's files indicated were writing truck insurance.

The American Trucking Associations analyzed the list and found that 90 percent of the companies listed were writing truck coverage only incidental to the other insurance business they have with manufacturers or shippers that have private fleets. In other words, only about 10 percent, 70 insurance companies in the Nation, are active in what we call the for-hire trucking insurance market. Unfortunately, many of these underwriters are in dire financial straits, too. As a result, rather than 700 only about 30 insurance

companies that appear financially sound are writing for-hire trucking insurance.

We are in the process of doing a survey with our members to find out how many of our members have been put out of business since this insurance thing started. I agree with Cliff; everything that I've read seems to indicate that the problem is going to get worse before it gets better. In other words, it's not something that is going to be over shortly. It's an ongoing situation. Speaking for the trucking industry, I guess we either find a solution to the dilemma or truck transportation is going to come to a halt, not only in South Dakota but all over the United States.

Senator PRESSLER. Well, I thank you both for excellent statements. I have some questions for each of you.

Let me first of all say that the committee is asking the insurance industry for some very specific figures in our February hearings because—and Cliff, you mentioned deregulation and the deregulatory environment. Let me say that in my time on the Commerce Committee, there are many people who have advocated complete free enterprise, and that's the goal of all of us, I suppose.

On the other hand, if we put pressure on the Defense Department to cut costs by contracting out air transport—we had that disaster in Gander. It might not have been a fault of the private company, but the concept that by contracting things out should get rid of Federal employees, theoretically; you do it to the lowest bidder. Now, we're finding that we're going to have to have more Federal inspection of some of the contracting companies.

The point I'm making, is that it's never quite as simple as the slogans when you get down to policymaking. In terms of deregulation of the airlines and of the transport industry, it's been hard on this part of the country and I have opposed it. And we're finding in the eastern corridor regarding the safety of airlines—since the surface transportation has deteriorated and bus and train—the air corridors are overloaded. We have a lot of new entries who have low-paid pilots—I'm not saying all of them aren't good or bad—but the point is there are public policy questions tht sometimes the Federal Government has got to get involved. And my basic grain is to run against being involved. But we may find this with the insurance industry. We may find it with our legal system, we have to pass legislation.

Let me ask each of you a question. First of all, Cliff, how does this really affect the grain elevator operators and what does this mean to the farmers? For example, a co-op elevator in some town, what's the real effect of this?

Mr. ANDERSON. Well, to begin with—and Jerry talked about this restoration thing. I think that's the same thing we're talking about, is pollution control. And we had this situation up in Brookings where there was a fire up there in a little company that handled agricultural chemicals. Brought the Federal Government into the scene to clear up the premises. And I assume maybe he thought this was a beneficial act, but when they got done trucking his soil to South Carolina or some place, they handed him a bill for over $1.5 million. An insurance company eventually got stuck for

that, or to the limits of their policy. Totally unforeseen exposure, I'm sure.

All of these country elevators handling chemicals, they have transformers with PCB's in them. They have all kinds of things that potentially could get into somebody's water, underground water system. For example, you could have a thousand claims against the company if carbon tetrachloride shows up in the water system around.

The insurance companies—in self-defense, I would have to say—are talking about eliminating pollution coverage from their basic policy and saying, "If you want it, you're going to have to buy it elsewhere." The plain fact is, I think it's very doubtful if they could buy it elsewhere.

What this is going to do, I'm fearful, is that as with the asbestos industry and a lot of other things, if you're going to want to continue to handle agricultural chemicals, you're going to have to set up some kind of a dummy corporation or a bare bones corporation that's got nothing in it and have them handle this without any coverage. And the consumer or the public is the one that's going to suffer with this.

But I do think you have to recognize that here is—here is an industry, an insurance industry, that in no way can cope with this sort of thing that happened in Brookings. And when you're talking about a million dollars in premiums, Jerry, with a good loss ratio, the fact is that one bad lawsuit with punitive damages is going to take ten times that amount or more.

Senator PRESSLER. Jerry, you mentioned that Dan Dugan Transport recently went out of business. I might say that's of great interest to me. When I was at the University of South Dakota I had what they call a "partial Dan Dugan scholarship." I don't know if it was ever known publicly that Dan Dugan did a lot of things like that. But, did I hear you correctly in saying that the single most important reason for this business failure was the liability insurance problem. Is that happening elsewhere?

Mr. WHEELER. I hope I didn't say it was the single most important reason. I said it was one of the reasons. I think deregulation of the trucking industry was a major factor, and that's also a factor in the insurance problems that we're having. I do appreciate all of the work that you've done in that area because it stands to reason as thousands more carriers have got into the business, they've sapped up the insurance market; in other words, somebody had to insure all of those carriers when they were coming into business.

When you talk about Dugan's, it's a combination of truck deregulation and—the insurance thing which is certainly an issue. When a carrier looks at January 1 and his type of company says that he can't buy restoration insurance, that's certainly a factor. I don't want to believe that that's the only factor, but it's one of the contributing factors.

Senator PRESSLER. Of course, truckers are in a slightly different situation than some other businesses in that they are required to carry a certain level of liability. In some ways South Dakota is vis-

ited by the sins of other States, so to speak, in a sense that we have to deal with insurance on an interstate basis. And that is, of course, maybe an argument for some product liability uniformity. Would your group support the Federal Government getting involved in terms of setting uniform standards of negligence statewide?

Mr. WHEELER. I certainly think we would, because we do suffer considerably, in every type of insurance. For instance, if a carrier has a worker's compensation claim, it's much more convenient if that employee happened to suffer that claim in Minnesota, for instance, than it was South Dakota. And, of course, your example in New Jersey and California is a good one. So I think, yes, we would support that type of bill.

Senator PRESSLER. And I very much appreciate your comments about the whole problem, the insurance companies also. And the Commerce Committee has requested some very specific numbers which will be presented during a late January hearing. I think that's an important thing to point out. We will submit your entire statements for the record.

I thank you very much for being here, and we will turn to our next panel, which is Bob Miller, executive director of the South Dakota Municipal League, and Dr. Frank Alvine, chairman of the Commission on Professional Liability, South Dakota State Medical Association.

Let me say—I've introduced two State representatives. Also, State Representative Ann Lewis is here; Could she be recognized?

And also, I'd get into great trouble if I didn't introduce my wife. My wife, Harriet, is here.

All right. We will hear from Bob Miller. Bob, welcome.

STATEMENT OF ROBERT MILLER, EXECUTIVE DIRECTOR, SOUTH DAKOTA MUNICIPAL LEAGUE

Mr. MILLER. Good morning, Senator. Thank you.

Senator PRESSLER. Speak right into that microphone. Pull the other ones over—it might be helpful, or it might not—so they can hear in the back row. Wave your hand if you can't hear. We've got a veteran witness up here, so he can speak right up.

Mr. MILLER. Thank you, Senator. My name is Bob Miller, and I'm the executive director of the South Dakota Municipal League. The league goes back to 1934 and it's an association made up of 298 South Dakota cities out of 300.

I want to thank you, Senator Pressler, and your committee for coming here to conduct a field hearing on the liability insurance crisis. The crisis is one of affordability and availability of liability insurance for rural America.

The cities of South Dakota, because of premium increases, policy cancellations and nonrenewals, are being forced to go without insurance or to reduce coverage. South Dakota cities are also being forced to reduce services. Brookings was unable to open a brand new snow-sliding hill because no one would insure it. The town of Mission closed their swimming pool for the same reason. The fol-

lowing are actual examples of premium increases for umbrella liability coverage from 1984 to 1985 in South Dakota. Very briefly, Aberdeen was up 277 percent; Rapid City was up an astounding 1,210 percent. The average umbrella liability increase for South Dakota cities over 5,000 population last year was 213 percent.

Looking very briefly at public official liability, Aberdeen was up 392 percent; Rapid City was up 313 percent; Spearfish was up 104 percent. Statewide, our average for cities over 5,000 population was 126 percent. In every case deductibles were up and coverages were down.

Interestingly enough, a year ago we were able to convince our State legislature that we should pass a liquor liability law for cities in the liquor business, simply saying that cities are immune for the actions of individuals who buy their liquor from the cities, total immunity. Yet, liquor liability insurance last year for cities that are in the liquor business went up an average of 107 percent.

Attached to my formal testimony are some reports from four South Dakota small cities: Canova, with a population of 194; New Underwood, with a population of 517; Roscoe, with 370 people; and Wall, with a population of 770. I've submitted these simply to show you that even by South Dakota's standards it's not a large city problem. It's a small city problem, as well.

The experts have all pointed to a variety of causes for the current insurance problem we're facing, including things like cash-flow underwriting, which really is a polite name for poor investment and management practices used by insurance companies; and reinsurance companies who insure insurers against excessive loss or liability have played the same money game. They've used the return on investments to offset their underwriting losses and, like the primary insurers, they suffered losses when stock prices and interest income dropped. Other causes include increases in litigation against cities and public officials; on a national level it is estimated to be up 400 percent. Now, we don't have any figures like that for South Dakota. I'm hoping maybe the committee can help me get the data.

The fact is, there's no way the insurance industry can fully recover from this current down cycle unless the Congress and the State legislatures impose order on our legal system. Louisiana and Pennsylvania both kind of led the way. They've taken a big step with laws that curb pain and suffering awards from local government. It's only a start. Remedies in law will not become effective overnight.

One unpopular—but simple—solution would be to prohibit or limit the contingency fee system that encourages lawyers to seek the highest possible damages. We must be careful, however, not to deny judicial relief to our poor people.

The plight of municipal government is acute because all of the residents of the city are affected either by soaring insurance costs or by exposure to costly awards if the city cannot obtain insurance.

Regardless of who or what is to blame for this mess, the current municipal liability crisis is real and dangerous. It is becoming clear that the insurance industry will not be able to or is willing to solve the problem.

In the long run, perhaps the only real solution is legislative action to define liabilities and cap them at fair and reasonable levels. The Senate has considered a proposal by Senator Kasten, of which you were one of the cosponsors, that would put a limit on corporate liabilities. Perhaps this could be used as a basis for extending limits to other areas.

It is crucial that the Federal, State, and local Governments work together. We see a definite Federal role; we are not sure what that role is, but your help is needed now. Thank you, Senator.

[The prepared statement of Mr. Miller follows:]

PREPARED STATEMENT OF ROBERT MILLER, EXECUTIVE DIRECTOR, SOUTH DAKOTA MUNICIPAL LEAGUE

My name is Robert Miller, and I am the Executive Director of the South Dakota Municipal League. I wish to thank Senator Pressler and the members of the Senate Small Business Committee for coming here to conduct a field hearing on the liability insurance crises. The crisis is one of affordability and availability of liability insurance for rural America.

The cities of South Dakota, because of premium increases, policy cancellations and non renewals are being forced to go without insurance or to reduce coverage. South Dakota cities are also being forced to reduce service. Brookings was unable to open a brand new snow sliding hill because no one would insure it. The town of Mission closed their swimming pool for the same reason.

The following are actual examples of premium increases for umbrella liability coverage 1984-1985.

Aberdeen up 277.26%

Rapid City up 1,210.60%

Public official liability

Aberdeen up 392.14%

Rapid City up 313.27%

Spearfish up 104.10%

Please accept the reports from these four South Dakota towns: Canova (population 194), New Underwood (population 517), Roscoe (population 370), Wall (population 770). The problem is not a large city problem even by South Dakota standards.

Experts point to a variety of causes for the current insurance problem, including cash flow underwriting, a polite name for poor investment and management practices used by insurance companies. Re-insurance companies, who insure insurers against excessive loss or

liability, played the same money game. They used the return on investments to offset their underwriting losses and like the primary insurers, suffered losses when stock market prices and interest income dropped. Other causes include increases in litigation against cities and public officials on a national level is estimated to be up 400% in the past five years. We do not have figures for South Dakota. Perhaps you can help us get them from the insurance industry.

The fact is, there is no way that the insurance industry can fully recover from this current down cycle unless Congress and the state legislatures impose order on our legal system. Lousianna and Pennsylvania have both made a big step in that direction with laws that curb pain and suffering awards from Local Government. It's only a start. Remedies in law will not become effective over night.

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In the long run, perhaps the only real solution is legislative action to define liabilities and cap them at fair and reasonable levels. The Senate has considered a proposal by Senator Kasten, that would put a limit on corporate liabilities. This could be used as the basis for other limits.

It is crucial that federal, state and local governments must work together. We see a definite federal role. We are not sure what that role is but your help is needed now.

Thank you.

	1984	1985	1984 coverage	1985	cost
Ambulance malpractice	none	First Nat'l of Am.	none	500,000/500,000	927.00 - 85
Ambulance Equipment	Midwest Mutual	First Nat'l. Ins. co of Am.	500 deductable	same	767.00 - 84 948.00 - 85
Ambulance vehicles	Midwest Mutual	First Nat'l Ins. of Am.	500 deductable	same	896.00 - 84 2,603.00 - 85
Ambulance Umbrella	none	First Nat'l Ins	none	1,000.000	1,000.00 - 85
Public Officials & Employee Liability	none	First Nat'l Ins	none	500,000/500/000	865.00 - 85
Officials & Emp Bond	Western Surety	same	50,000.00	same	209.00 - 84 209.00 - 85
Institutional (Liability, Property, etc.)	Midwest Mutual	Home Insurance Co.	500,000.00 500 deductable		4,065.00 - 84 11,803.00 - 85
Airport Liability	no coverage	U.S. Fire Ins. Co	1,000,000		850.00 - 85
Workmens compensation	Home Insurance	St. Paul Fire & Marine			3,942.00 - 84 4,238.00 - 85
Auto Insurance	Midwest Mutual	Home Indemnity	500 Deductable	same	2,192.00 - 84 6,007.00 - 85
Excess Liability	Gret Southwest Fire	Constitution State Ins	1,000.000	same	731.00 - 84 1,795.00 - 8

CITY OF NEW UNDERWOOD

Comparison of Premiums for 1984 and 1985

POLICY	COVERAGES	INSUROR	1984, PREMIUM	1985 PREMIUM
Package Policy	Property, General Liability, Police Professional & Public Officials Liability Limit $500,000	Preferred Risk	$1,759.00	
Automobile	Limit $500,000	Preferred Risk	$2,317.00	
Umbrella	Limit $1,000,000	Crum & Forster	$ 495.00	
Property Policy	Same Coverage as 1984	Hartford		$1,061.00
General Liability	Comprehensive General Liability including broad from CGL and Police Professional Limit 500,000	Hartford		$1,296.00
Automobile	Limit 500,000	Hartford		$3,746.00
Public Officials	Limit $1,000,000	Hartford		$ 525.00
Umbrella	Limit $1,000,000	Integrity Ins. Co.		$1,000.00

Total Premiums Paid 1984 $4,571.00

Total Premiums Paid 1985 $7,628.00

TOWN of CANOVA COMPARISON OF INSURANCE SCHEDULE

POLICY	INSURER-1984	1985	COVERAGES-1984	CHANGES-1985	PREMIUM
General Liability	Western Surety	Security Ins. Agency	$100,000. body injury $100,000. property damage	$300,000. Lineback/$500. deductible 100,000/1,000,000	1984 913. 1985 1,580.
Employee Bond	Western Surety	same	Fin. Off. $2,500. Others $1,000.	none	1984 33. 1985 35.
Auto Ins.	Western Surety	same	50/100M body injury 25,000. property damage 50/100M uninsured motorist	none	1984 313. 1985 354.
Workmen's Comp.	Western Surety	North Central	coverage statutory	none	1984 682 1985 461.
Library	Milbank	same	Contents $15,000. $100. deductible	none	1984 111. 1985. 111.
			TOTAL 1984 PREMIUMS PAID TOTAL 1985 PREMIUMS PAID		$2,052. $2,541.

CITY OF ROSCOE

COMPARISON OF SCHEDULE OF INSURANCE IN FORCE AND PREMIUMS PAID-FOR YEARS OF 1984 AND 1985

POLICY	INSURER-1984	INSURER-1985	COVERAGES - 1984	CHANGES - 1985	PREMIUM
Position Bond for Finance Officer	Western Surety Co.	SAME	Finance Officer- $50,000.00	NONE	1984-$225.00 1985-$225.00
Workmen's Comp.	Preferred Risk Group Ins. Co.	American Ins. Co. Firemens Fund Group	All employees - Bodily Injury by accident $100,000. ea. accident - Bodily Injury by Disease $500,000 policy limit - Bodily Injury by Disease $100,000 ea. employee	NONE	1984-$1,024.00 1985-$914.00
Commercial Umbrella	U. S. Insurance Group	*** SAME	Liability - $1,000,000 ea. Occurence $1,000,000 Aggregate Limit Self insured retension - zero	NONE	1984-$500.00 1985-$900.00
Commercial Auto	Midwest Mutual Ins. Co.	Hartford Casuality Ins. Co. Twin City Fire Ins. Co.	Liability - $500,000 for any one accident or loss. Auto medical payment Ins. $2,000. Uninsured Motorist Ins. $500,000. Deductible- Comprehensive - $50.00, Collision - $250.00.	** Under-insured Motorist- $500,000.	1984-$1,204.00 1985-$2,140.00
Errors & Omissions	Preferred Risk Group Ins. Co.	Hartford Casuality Ins. Co. Twin City Fire Ins. Co.	Public Officials E. & O. $1,000,000 ea. Claim - $1,000,000 Aggregate. Public Officials - E. & O. - IMM/IMM - $500. deductible ea. claim.	NONE	1984- Incl. w/ Comm. Pkg. & Gen. Liability Unable to break down. 1985-$350.00
Commercial Pkg. Bldg. & Equip. & Prof. Police Liability & Gen. Liability	Midwest Mutual Ins. Co.	*** Hartford Casuality Ins. Co. - Twin City Fire Ins. Co.	$500,000 ea. Occurence - $500,000 Aggregate - Deductible - Bldg. - $250. Equip - $100. Total Blanket Coverage $518,250.	Deductible -Bldg. $100.- Equip.- $250. Total blanket Coverage - $676,125.	1984-$1,654.00 1985-$2,920.00

* - 1985 Fire Truck was added to policy in 1985 for a premium amount of $1,041.
** - Mid-year change in 1985: $750,000 ea. occurence & aggregate.
*** - Total & absolute pollution exclusion in policy.

Senator PRESSLER. Thank you very much.

We will now call on Dr. Frank Alvine, chairman, Commission on Professional Liability, South Dakota State Medical Association. Doctor, we thank you very much for taking time off from what is a very busy schedule.

STATEMENT OF FRANK G. ALVINE, M.D., CHAIRMAN, COMMISSION ON PROFESSIONAL LIABILITY, SOUTH DAKOTA STATE MEDICAL ASSOCIATION

Dr. ALVINE. Senator Pressler——

Senator PRESSLER. Let's get the microphone on again.

Dr. ALVINE. Senator Pressler, my name is Dr. Frank Alvine, orthopedic surgeon, practiced in Sioux Falls for the past 13 years. I'm currently chairman of the Commission on Professional Liability of the South Dakota Medical Association.

I'm particularly pleased to be asked to appear before the Small Business Committee of the U.S. Senate since medical practices are indeed small businesses and——

Senator PRESSLER. Can you hear in the back? Please move a little closer to the microphone.

Dr. ALVINE [continuing]. Since medical practices are indeed small businesses and this problem is affecting their overall function and, in some instances, threatens their very existence. I suppose one could logically testify on this subject before 5 or 10 subcommittees dealing with health, welfare, judiciary, and so on. This problem transcends more than one profession, one business or one State because it clearly affects all of the country's 225 million people.

I will not attempt to review the litany of national statistics on this subject. South Dakota, because of its relatively rural and isolated location, is not yet plagued with heavy court dockets or multimillion dollar awards. We are too small to justify our own physician-owned liability insurance company, and thus my colleagues around the State and I are dependent on the national commercial market with better than two-thirds of South Dakota physicians insured by one company. Our premiums, therefore, are a direct reflection of national trends.

I practice general orthopedics with five other orthopedic surgeons and we have experienced a rapid increase in our premiums for the same coverage over the past 5 years. We presently pay $154,000 for $1 million to $3 million in coverage. We found we're essentially locked into our company in that to change companies necessitates basically buying out the tail of the present insurance carrier which, in a recent attempt to switch, the cost was approximately $210,000.

I do not think the premium dollar is a primary issue here. The exposure to unlimited liability has resulted in denying care to groups of patients, particularly obstetrical and high-risk surgical cases. Since we are working in an inexact science, we are in many instances at the mercy of the legal climate should a complication or adverse outcome occur. Therefore, we are not doing certain surgical procedures that we are fully trained to do and are forced to practice defensive medicine. Surgical cases are being referred out of South Dakota that would normally be treated in our locale.

I am proud of the tort reforms in medical liability instituted by the South Dakota Legislature during the past decade, and I am pleased that our courts have so far had no quarrel with this legislation. Because we think further reforms are now necessary, our State Medical Association has adopted a package that, in addition to other measures, also includes an absolute cap on awards of $500,000.

Some States have been more diligent, or fortunate, in the extent of tort reform adopted; some have been less so. Unfortunately, the nationwide pattern in reforms instituted and in court review of these reforms is mixed and very confusing. Furthermore, State boundaries are a hindrance when the medical profession deals with commercial liability insurance carriers who are regional or national in their operation, and when court cases in one State are immediately cited throughout the country.

I'm not sure we can afford 51 approaches to tort reform when a citizen in one State can conceivably wind up with a multimillion dollar award, and a citizen in another State with a similar case might end up with nothing. Furthermore, some States have established procedures which have caused liability rates to increase less steeply, or even stabilize or fall, while other States have done little or nothing and seem content to watch the medical liability rates increase geometrically, thereby adversely affecting everyone within its borders.

With this climate in mind, I am intrigued by—and consider myself an early supporter of—S. 1804, the Health Care Professional Liability Reform Act of 1985. I support this concept for several reasons.

One, it does not compel the States to do anything. I have long opposed undue regulation from the central government, but occasionally the States are individually unable to address problems of a national scope and this brings about Federal concern. It may be that Federal activity in medical liability tort reform is an idea whose time has come. This legislation provides monetary and other incentives for States to pass specified tort and judicial reform legislation. It leaves with the States the responsibility of evaluating the nature and dimensions of the problems they face. It will not encourage greater Government regulation or worsen the Federal deficit.

Two, S. 1804 asks for action in several areas which many States have already found to be most productive, starting with the offset of collateral benefits against damage awards and capping noneconomic damages. Periodic payments of damages is a reasonable contribution to the problem and I would like to think it is also reasonable to limit attorneys' fees equitably. These four tort reforms and several nonjudicial provisions have an established "track record" in the States, which commends them to more national usage.

Three, the bill does not expect change from one segment of the medical liability "industry" but asks cooperation and assistance from several entities: insurance companies, the legal profession, the medical profession, hospitals, State medical societies, State licensing agencies, State disciplinary agencies, the patients and the courts. This seems like a fair approach to the crisis, rather than coming down hard on just one or two entities.

Senator Hatch's bill offers a beginning dialog. It speaks for the gravity of the situation and proposes options for dealing with the problem. It is highly unlikely that it will change the premiums paid by physicians to continue their practice, especially in certain high-risk fields, since most of S. 1804's provisions are geared at the patient or the victim's side of the problem and do not deal with the physician side of the problem directly. I hope all States would be moved by this legislation, however, to get more serious about how they individually want to confront a very serious national problem.

Ten years have passed since the initial movement to enact tort reform. Some of these reforms were not as effective as we had hoped. Some have been declared unconstitutional in some States. Meanwhile, the march of time has produced a multitude of changed circumstances in the past decade: ever more sophisticated medical knowledge and procedures; runaway inflation until recently; spiraling medical costs, and an increasingly litigious society in all fields, not just medical.

With the experience our States have had with tort reform, I think it is now time for Congress and the President to encourage a faster pace. S. 1804 allows this in reasonable measure. I encourage your further consideration of this legislation as an important step in recognizing the unusual vulnerability of physicians providing medical care and in establishing more moderate, but fair, procedures for compensating meritorious suits arising from medical malpractice. Thank you.

[The prepared statement of Dr. Alvine follows:]

PREPARED STATEMENT OF FRANK G. ALVINE, M.D., CHAIRMAN, COMMISSION ON PROFESSIONAL LIABILITY, SOUTH DAKOTA STATE MEDICAL ASSOCIATION

I wish to express appreciation for this opportunity to share some of my perspectives on the medical liability insurance crisis. I have been a practicing orthopaedic surgeon in South Dakota for the past thirteen years. I am currently chairman of the Commission on Professional Liability of the South Dakota State Medical Association.

I am particularly pleased to be asked to appear before the Small Business Committee of the U.S. Senate since medical practices are indeed small businesses and this problem is affecting their overall function and in some instances threatens their very existence. I suppose one could logically testify on this subject before five or ten subcommittees dealing with health, welfare, judiciary and so on. This problem transcends more than one profession, one business or one state, because it clearly affects all of the country's 225 million people.

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liability tort reform is an idea whose time has come. This legislation provides monetary and other incentives for states to pass specified tort and judicial reform legislation. It leaves with the states the responsibility of evaluating the nature and dimensions of the problems they face. It will not encourage greater government regulation or worsen the federal deficit.

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Senator PRESSLER. Thank you very much.

You mentioned Senate bill 1804, which, incidentally, I am a cosponsor of. This bill, in my view, would be one thing the Federal Government could do. The other is something along the lines of product liability. But I'd like to address a question to each of you. As you know, recently all the trends have been toward less Federal regulation, less Federal control, the new federalism.

And what we're talking about in this area is perhaps more Federal regulation of insurance companies, or at least more investigation and oversight; more involvement of the Federal Government in the court system, and changing States' rights basically to set liability standards; getting the Federal Government involved. And basically, S. 1804 would put a $250,000 limitation on punitive damages. It should be emphasized that's not total damage; you can still get medical damages, career damages, and so forth.

What about this? The Federal Government is about to embark on this course—in part because of the public outcry. I'd much rather leave this to the State legislatures. Maybe they will. Doesn't this run contrary to all of our philosophy?

Dr. ALVINE. Well, I—to answer that question, I think that the States have been fragmented in their attempt to handle the problem. I'm told that the airline industry, when they were in a crisis—their industry was protected by a $750,000 absolute cap, which I'm not sure how long it's been in effect, but it's been cited as a means of somehow containing the—the exposure to unlimited liability. There are five States that have also instituted caps around the country, but I think that the—the way the States are approaching it, it's not been uniform and the liability that physicians are exposed to is so variable and the rates are going up so rapidly that it appears that some form of Federal legislation would be necessary.

Senator PRESSLER. Bob.

Mr. MILLER. Senator, it's difficult for me personally, as a representative of the cities, to sit here and tell you that I want Federal Government messing around in our affairs. But we've reached a point where we have no option. We have to have the help.

Senator PRESSLER. OK. I appreciate that very much.

Now, Dr. Alvine, could you give me some examples of doctors going out of practice—I know in California and some States I've seen on "60 Minutes," that this is occurring. I don't know if this is happening in South Dakota. But what is this doing to—first of all, what is it doing to doctors? Second of all, more importantly, maybe, what's it doing to consumers of medical services in terms of the price they have to pay. Also, what percentage of the average fee you pay a doctor or the hospital is insurance?

Dr. ALVINE. I'm not sure I can answer all those questions, but I know that in some States the physicians are just not doing certain surgical procedures because of the exposure to the risk factor in the surgery. I think that this is spreading around the country.

I think that in South Dakota, now, we are also certainly adding a factor of anxiety to every patient that we see with a medical problem, that for us to treat that particular patient, we know that they're facing additional risk before we do the surgery and we make an effort to explain that to them. However, if in the future a

complication does occur, we then have to convince the attorneys that, indeed, all the bases were covered.

Does that answer all of your——

Senator PRESSLER. Yes, I think so. Are we losing doctors from certain areas of practice?

Dr. ALVINE. Certainly in the obstetrical field they are very concerned that they're not going to get medical insurance, liability insurance, in the near future. In some sections of the country, mainly the southern part of the country, obstetrical care is just not available through the normal channels. The obstetricians and gynecologists, I understand their premium went up to $21,000 a year this year, also. So who is going to deliver the children? I just don't know at the present time.

Senator PRESSLER. Well, I think the story you told here is a dramatic one.

Turning back to the cities, Bob, could you describe for us the Municipal League's efforts in putting together its own insurance company? Are you running into any snags? And if so, what could be done to make this kind of self-insuring mechanism simpler or easier?

Let me say for the benefit of those who are not familiar with some of these, issues, what some say will happen is that certain groups will band together to get insurance, which will make it even more expensive for those who are not members of those associations or those groups. And those groups will probably be very prosperous businesses and have stable businesses; and they group together and get group insurance, as I understand it. The people who are outside of those groups will be in even tougher shape. That's kind of the business point of view. Tell us how that would come along regarding cities.

Mr. MILLER. Senator, we're taking a look at two or three different alternatives for the cities of South Dakota and neighboring States, one of which would be to create our own mutual insurance company. Another would be to form an insurance pool, a multistate or just within South Dakota. We have two or three options that we have hired feasibility studies done on, and we've not made that decision which way we're going to go; but we have to look at that as an alternative to the traditional forms of insurance.

Senator PRESSLER. Thank you very much. I will call our last panel forward, who are Roger Larsen, president of Williams Insurance, and Ms. Susan Walker, the very able commissioner of insurance for the State of South Dakota.

Let me say that as I look around the room there are many people here—and do come on forward—who we should hear from before, but lack of time perhaps limits us. But anybody who wishes to write out a statement about their experiences, we will make it a part of the official record. Also, at the end we sometimes allow—if people can keep their statements down to 2 minutes—anybody from the audience can come forward until about noon and make a 2-minute statement. So if you wish to make a statement, be thinking of how to summarize it. The committee's tradition in the field is to limit those to 2 minutes.

We have two good friends here. We thank you very much for traveling here. Which of you would like to go first? Susan, would you like to go first, or Roger? You decide.

Ms. WALKER. OK.

Senator PRESSLER. Do you have the microphone, the right microphone?

Ms. WALKER. Yes Senator.

STATEMENT OF SUSAN WALKER, DIRECTOR, DIVISION OF INSURANCE, STATE OF SOUTH DAKOTA

Ms. WALKER. I am Susan Walker, director of the South Dakota Division of Insurance.

Senator PRESSLER. Bring that a little closer.

Ms. WALKER. Usually there hasn't been any problem with people being able to hear me, but I'll start again. Thank you.

I am Susan Walker, director of the South Dakota Division of Insurance. I want to thank Senator Pressler and members of the Small Business Committee for affording me the opportunity to appear at this hearing to discuss a very critical issue of paramount importance to our State.

The Governor and members of the NAIC, which is the National Association of Insurance Commissioners—which is an association comprised of the chief insurance regulators of all the 50 States and the U.S. territories—share the concern regarding the insurance availability and affordability. This problem, as it was evidenced by the speakers already today, is not unique to South Dakota. It is nationwide in scope.

Throughout this year the NAIC has met with industry and consumer groups alike in an attempt to facilitate immediate responses to the availability crisis and has initiated activity to address long-range solutions. The problem of insurance availability and affordability can be attributed to a number of factors. I am not going to reiterate those particular factors; I think they've been adequately identified by those members testifying prior to me.

I will just touch briefly on those, and one which has already been alluded to is, for the past 5 years, insurance products have been underpriced. The warning signs were there as the frequency and the severity of losses increased. Underpricing was due in part to the vigorous competition among insurers during that period for premium income to rise at high yields of interest in the financial markets. Companies ignored sound underwriting practices and operatives for cash flow operations.

Until 1983, growing investment income fueled by high interest rates was able to offset underwriting losses. But in 1984, a modest 10.6 percent increase in investment income totaling approximately $1.7 billion for the insurance industry was not able to overcome a substantial increase of $8 billion in underwriting losses. The industry sustained its largest loss in its history of $3.8 billion in 1984.

We have to look specifically at the commercial and the professional lines, which is the area where we are seeing the availability and affordability crisis. The underwriting losses in these two particular lines total $16.8 billion. Now, these losses represented 79 percent of all the underwriting losses in 1984, whereas the premi-

ums for commercial and professional lines represented only approximately 51.3 percent of the total industry premiums.

As Mr. Anderson alluded to, the forecast does not look much brighter for 1985 and into 1986. As a consequence, we are now facing the problem. We are starting to look at true underwriting considerations. And unlike in the past, where we were taking large blocks of business, they're being more scrutinous into the particular lines that they wish to underwrite and to who those particular coverages will be offered.

The second problem is the constrictions and the availability of reinsurance. In 1983 and in 1984 reinsurers were hit even harder by losses than the direct market. In 1983, reinsurers had a six-point higher combined ratio to premiums of 118 as opposed to 112 in 1984. And it was 10 points higher—excuse me, in 1983; excuse me. And in 1984 it was 10 points higher, 128 as opposed to 118. We are evidencing a partial—and in some cases, total—withdrawal of major reinsurers in the United States, in Great Britain, and Western Europe.

The third factor that I would identify that's probably been discussed more today than any is the tort reform in our civil liability and judicial system. The Insurance Services Office data reveals that legal defense costs now account for nearly 35 cents of every dollar incurred by the insurance industry. I'm going to provide you with a scenario in one particular line which was addressed, and that's municipal liability. This is based on all policies issued in—over the course of the last 4 years, nationwide.

In 1980 there were 3,000 claims under municipal liability; in 1981, there were 5,000; in 1982, 7,000; and in 1983, 10,000 claims. You can see the escalation in the frequency of those claims. Total losses on those claims in 1980 totaled $29 million. For those accounted for in 1983, the total figure was $24 million. That's not—there was a loss ratio of 200 percent. And that does not take into account the expense costs.

I think more fundamentally, the industry has had great difficulty in predicting its losses and making adequate provision for them. The unpredictability and the costliness of the liability system as it has evolved bear a direct relationship to the current problems with availability and affordability.

A few examples cited by the industry and also acknowledged by the National Association of Insurance Commissioners—and I'm not going to analyze all the topics; that would be probably a—a Law Review article or a full volume, but let me just cite you a few examples.

Insurance contracts have increasingly been ignored, even when the language is clear. I think a pertinent example of this is the *Jackson Township* v. *The Hartford Accident and Indemnity*, in which the policy provided for only accidental pollution coverage. The court read the policy to—read into the language—that it included coverage for gradual seepage and pollution problems. I'll have to refresh my memory, but I believe that the total liability—I'm not going to say that. But all I'm saying is that the liability which the insurance company felt was clear on any type of maximum liability for accidental pollution coverage was about ten or

fifteenfold what the court held in rewriting, so to speak, the insurance contract.

There has been an abuse of the doctrine of joint and several liability where defendants with the deepest pockets are sued for all or a disproportional share of a plaintiff's damages, even though they may have been only marginally responsible. And this is where we're seeing a great toll in municipal liability, and this is where we see an increased number in claims. The municipality may only be partially responsible for some particular action, but they're—they are being required to pay the major portion of the plaintiff's damages.

Third, punitive damages. As the witnesses before me stated, there is no question that this has become the single most bargaining chip in negotiating insurance settlements. And this is what has come over the head of a number of insureds and insurance companies. It's the reason why a lot of times, even when you talk about frivolous lawsuits, they're willing to go ahead to try to attempt to settle just to bring the legal costs down and to avoid high punitive damage awards.

I don't think this is so indicative in South Dakota, but it is very indicative in other States in our Nation. And it's just like—we all have to look at the predictability factor. Until there is solid case law in identifying those particular facts in which punitive damages will be awarded, everyone sits here and wonders as to how legal precedent in other jurisdictions will be affected by a possible factual situation in South Dakota, or in those other neighboring States.

I think the last one that we're looking at, as far as civil justice reform and abuses in judicial decisions, is the state-of-the-art reforms. Courts have tended in recent years to permit the imposition of the liability based on standards that developed after the activity in question took place. And we're seeing a lot of this in—under your commercial and general—your commercial general liability lines.

Now, the steps to address these particular problems. There is no quick and easy solution. First of all, I feel that there needs to be—there is a need to place limits on the use of credits in underwriting. And this is part of the problem that we face. There were—South Dakota does have a prior approval. It is one of the States—it's about half-and-half as far as the 50 States. A number of them have file and use, which means that they have to file the rate where there is not prior approval. Once it is filed they are able to utilize that rate unless it would be called to your attention where, under some certain reason in law, they should be able—or the insurance regulator would be able—to withdraw that particular rate. South Dakota is prior approval.

In accord with the basic standard rates that are applied, they also ask for deviations and credits where applicable. I have no problems when credits are used in the proper sense, but I think what we've found in the market over the last 5 years is that credits were not being used properly. They were not used to identify those particular risks that were truly claim-free, those particular businesses that had an active risk management and were taking steps to reduce their claims exposure. It was being really offered to ev-

erybody, no matter if that person or that entity actually warranted the credit. So there was a problem in that particular aspect.

Again, when we talk about deviations from the bureau rates, this has caused many problems. And again, this kind of goes in line with particular credits or in other areas where they'll take the bureau rates but they'll kind of redefine the particular business entity or the risk associated with that to bring a lower rate.

One action that I took in South Dakota—and it probably would have been an unpopular one, although I didn't experience much negative feedback—we were seeing the exact same thing happening in crop/hail. We saw deviations of as much as 45 to 50 percent from the standard bureau rates. These particular bureau rates are established over many years of history and especially when you talk about crop/hail, seasonal weather conditions in the particular regions.

I felt just like a farmer, I'll tell you, that year. I watched the weather reports because I knew if we had sustained rate losses in the State of South Dakota, we would be having another availability and affordability here and that would be in the crop insurance industry. Thank goodness, we do not evidence that now.

Part of that is for my intervention into a "free enterprise" in limiting the amount of deviations which would be provided from the bureau rates for crop/hail. We allowed only a 10 percent. We brought the market in line. Crop/hail is now readily available from a number of insurances covering that particular coverage in this State.

But I think that—I think that we, as regulators, have to start taking a more active role in what deviations are going to be offered from standard bureau rates, and especially those companies that prescribe or file with particular bureaus. And the main one in the property casualty area is the Insurance Services Office.

Nonrenewals are a major problem confronting South Dakota and nationwide. This year I'm going to be introducing legislation which will require at least 60 days 'notice to policyholders prior to any nonrenewal of their insurance contract. I'm also going to include that in the event that the insurance company is desirous of continuing coverage, but the premium increase is going to be at a certain level—and I haven't decided exactly at what point—that also—they will also have to give 60 days 'prior written notice to avail the insured to shop for insurance.

The one thing that South Dakota has instituted, and also with the NAIC, is a voluntary market assistance program. And this is to assist insureds in our State or consumers in our State for hard-to-place coverages. The NAIC has set up a network with a number of surplus line brokers. We've been working on it all summer and helping individuals with day care problems and other particular lines that are hard to place. And we have been successful in assisting consumers in that area.

The last one I will mention is midterm cancellation, and South Dakota was the second State in the Nation to pass a midterm cancellation law. In fact, it was the first State to foresee this particular problem a year before it actually happened. Wisconsin already had the law on the books for a number of years. No other State had a midterm cancellation law. This was enacted and adopted

July 1, 1985, and the South Dakota Division of Insurance has been extremely involved in assisting in the halting of unwarranted midterm cancellations. We've assisted, as Mr. Wheeler mentioned, the Trucking Association and a myriad of—a myriad of other individuals that have likewise faced midterm cancellations.

It's been a busy year. It will continue to be so, but I feel that State regulation is alive and well. When we talk about the deregulation, we can't look at the insurance industry as being a deregulated industry. I think it's probably one of the most highly regulated industries in the Nation by all of the 50 State regulators.

The NAIC—we meet four times a year. We're actively involved in looking at possible short-term—these were some of the short-term solutions that we looked at. And there are long-term, and that's assisting in civil justice reform. And we're also looking at approving—I apologize; I'm speaking too long.

There are new policy forms that are being introduced by the industry, and that's the commercial general liability form. And I know that this particular policy has met with a lot of discussion at the NAIC. And there has been a number of revisions made to that form which I think will be a little bit more palatable, maybe, to regulators and the insureds alike. But I think the basic difference on this is that where we look at the affordability issue and the underwriting concerns, the inability to predict particular losses and loss exposure, with the new CGL form it is going to a "claims made" basis. OK; that means it only covers for particular claims occurring within that particular policy year of coverage, versus the occurrence basis form.

And then there has been a lot of litigation as to what insurer has primary responsibility for covering that particular claim, when was the exposure or when did that claim occur, what policy was in force at that time. And again, what we've gotten into is a predictability problem. South Dakota is going to approve the CGL form with the modifications.

And basically, we looked at different pricing structures with the tail coverage. And this was a major concern to our office. It's also the affordability on tail coverage. But I think it's all something that the States have to recognize as a possible solution to this problem. And one of the major problems that they do have is the exclusion of pollution; but again, we're not seeing the coverage—or let's just say that insurers are very skeptical of offering this particular type of coverage, and we'll just see more of a major withdrawal from the market if these types of policies are not able to be offered.

Again—and you alluded to it—I think that any time we see an industry in crisis, I think there are always solutions. I see more joint underwriting arrangements than in the past. The NAIC is looking now, and I'm also entertaining the idea of looking at group insurance for property and casualty lines. That's never really been provided before, and I think this is an area that we also have to look at where associations can kind of pool their interests together, that the premium volumes are great enough that there would be an insurer that would be interested in covering that particular liability or that risk.

As we mentioned, there is going to be a number of insurance—insurance-related legislation in the State legislature. I do not know

in what-all forms those will take. I just alluded to one of them that is going to be sponsored by the Division of Insurance, and there is a number of other bills that the Governor's office and myself are currently working on, but it has not been finalized, and so at this point I guess that it would be premature for me to comment on those particular pieces of proposed legislation.

Again, thank you very much, Senator Pressler.

Senator PRESSLER. And I thank you. Let me say that several years ago I used a very detailed letter you had written on an insurance matter in the Commerce Committee, and they found it very useful. So we appreciate your expertise and your presence.

Roger.

STATEMENT OF ROGER D. LARSEN, PRESIDENT, WILLIAMS INSURANCE AGENCY, SIOUX FALLS, SD

Mr. LARSEN. Good morning, Senator Pressler. My name is Roger Larsen, president of the Williams Insurance Agency in Sioux Falls.

Senator PRESSLER. I guess this is the live one over here. The folks in the back can't quite hear you.

Mr. LARSEN. Read any newspaper today and the strain on the insurance availability becomes very clear. Insurance coverage for everything from pollution liability to some forms of commercial insurance to day care centers to truck transport either cannot be purchased at all or, if available, the premium cost is beyond the financial grasp of the customer in need.

It is to help you and Members of Congress understand the issue, is why I am testifying today. I also hope to bring to this subcommittee's attention an understanding of the availability issue. As an independent agent, I wear two hats; one being as a member of the insurance industry representing several companies, and the other as an agent for our clients, the consumer. My job as an agent is to find coverage my clients need to stay in business and help find a way out of the availability crisis. To do this, I'd like to offer a few general observations on insurance availability, some suggestions on how to improve it, and then answer any questions.

Why is there an availability crisis? To understand availability, it helps to understand insurance—what it is, how it works, and how it is regulated. Market availability is not uncommon in the marketplace. Profits and losses are the features that constantly change that availability.

We're all familiar with the unique nature of insurance; companies assess risk, predict future losses, and reserve against those losses. And these companies rely on contractual certainty, economic stability, and the law of large numbers. It is also useful to remind ourselves that insurers are in the business of risk-taking to make, not lose, money as a highly competitive—and until recently, a profitable—business. No one should begrudge the industry the business decisions and marketing judgments necessary to ensure profitability.

To a large degree the decisions now being made, and the strain on availability and affordability now being felt, reflect forces beyond the industry's control. There has been a dramatic decrease in interest rates over the past 5 years, resulting in a severe loss in

planned investment income, and in some specialty lines now in the news there have been huge losses simply beyond the capacity of the industry to absorb. Tort litigation, decrease of investment income and record losses and settlement costs tell a large part of the availability story.

State regulation—another part of the story of insurance availability is State regulation. Although a member in good standing of the free market, the insurance industry is already highly regulated.

Depending upon the State, such choices as where and how to invest money, how to price a policy, and how much to reserve against losses and insolvency are scrutinized and sometimes constrained by regulation. In all States, insurance commissioners are charged with seeing to it that insurance pricing is not inadequate, excessive, or unfairly discriminatory. An important point, and something to keep in mind, is that insurance regulators have the authority to protect the industry from itself and the public from inadequate reserves and capacity should insurers price policies too low.

Insurance company behavior—there is a third part to this story, a component of the availability and affordability of insurance which is within the industry's power to control. Severely competitive underpricing when times were good, followed by ill-conceived efforts to make up lost ground too quickly, almost certainly have made a bad situation worse. Another reaction by the insurance industry is to treat all types of risk the same, to "class underwrite." It is clear that insurers are attempting to find a way to get out of writing a new piece of business in the current market.

Mr. Chairman, that, briefly, is the story as an insurance agent would tell it: an industry unique in function and cyclical in nature which has experienced an unusually damaging combination of tort trends, economic deflation, and record losses. Given these observations, what can be done to restore availability and affordability to insurance markets? What to do?

One, reassess and reform tort law. No issue is more fundamental to the current insurance crisis, nor more troublesome to the public's sense of fairness and reason, than the explosion in this country of litigation, court decree, liability assessment, jury awards, and settlement costs now associated with our tort system. This is not a problem necessarily that Congress can solve. Several and growing numbers of State legislatures are adopting tort reforms which may help nudge tort trends in a less-damaging direction.

Two, strengthen State regulation. As mentioned earlier in my remarks, State regulators have the authority and competence to address many of the quirks in industry behavior—underpricing, overpricing, overboard application of defensive strategies to risks not seriously affected. These regulators should be supported by agent and industry groups in their States and encouraged to design and implement regulations to help alleviate the availability crunch.

Three, alternative marketing plans. Where lines of insurance become unavailable or unaffordable in conventional markets, alternative means should be established—again, State-by-State and, where possible, by voluntary participation. Insurance carriers in

the State volunteer to review and underwrite proposals funneled to them through the agents 'association.

Where voluntary market assistance plans prove unfeasible, State regulators can mandate joint underwriting associations, requiring a group of carriers to underwrite and service certain risks, and then dividing the cost among all other carriers which operate in the State.

Four, interindustry task forces. Emphasizing voluntary market solutions to availability is always to be preferred, and affected industries at the local, State, and national level should be organized and encouraged to get together with each other and with insurance agents and companies to assess markets and offer proposals for increasing availability and reducing price.

What not to do? The temptation for Federal intervention will be strong, but based on past experience and on the possibility of making worse by Federal interference the distortions now plaguing liability markets, it should be strongly resisted.

One, do not federally regulate insurance. Proponents of Federal regulation are less concerned with insurance availability than they are with the allocation of insurance funds in ways they deem socially or politically desirable. By imposing additional costs, constraints, inefficiencies, and market distortions, Federal regulation could be expected to make matters worse. State regulation is fully up to the task of regulating for solvency, availability and affordability and can be modified or abandoned without affecting the entire industry.

Two, do not establish Federal insurance programs. While on the surface Federal reinsurance or direct insurance for coverages otherwise unavailable seems plausible, experience has shown Federal insurance programs don't deliver. Federal crime, flood, crop, and nuclear insurance programs—to name only the most visible examples—consistently lose money, are plagued by operating and servicing inefficiencies, and usually end up serving political rather than economic or market objectives.

Three, do not mandate insurance coverages or liability limits. Hard as insurance availability is to live with, there are usually market reasons to account for the crunch. Government has never been good at repealing the laws of economics, and to the extent coverage is mandated it will be at taxpayer expense since the market has already determined it cannot be provided for a profit. Similarly, mandated liability limits where insurance is otherwise available— Motor Carrier Act limits, for example—inject exactly the kinds of market distortion and increased prices that quickly dry up whatever coverages might have been purchased. Truck insurance, for example, is not today unavailable; it simply can't be afforded at the artificially-high liability limits the Motor Carrier Act has imposed.

Mr. Chairman, that concludes my remarks. I would be happy to answer your questions and hope that information I've provided will help your subcommittee understand the availability crisis. Thank you.

[The prepared statement of Mr. Larsen follows:]

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PREPARED STATEMENT OF ROGER D. LARSON, PRESIDENT, WILLIAMS INSURANCE AGENCY, SIOUX FALLS, SD

GOOD MORNING MR. CHAIRMAN. MY NAME IS ROGER D. LARSEN, AND I AM PRESIDENT OF THE WILLIAMS INSURANCE AGENCY IN SIOUX FALLS, S.D.

READ ANY NEWSPAPER TODAY AND THE STRAIN ON THE INSURANCE AVAILABILITY BECOMES VERY CLEAR: INSURANCE COVERAGE FOR EVERYTHING FROM POLUTION LIABILITY TO SOME FORMS OF COMMERCIAL INSURANCE TO DAY CARE CENTERS TO TRUCK TRANSPORT, EITHER CANNOT BE PURCHASED AT ALL OR IF AVAILABLE, THE PREMIUM COST IS BEYOND THE FINANCIAL GRASP OF THE CUSTOMER IN NEED.

IT IS TO HELP YOU AND MEMBERS OF CONGRESS UNDERSTAND THE ISSUE IS WHY I AM TESTIFYING TODAY. I ALSO HOPE TO BRING TO THIS SUB-COMMITTEE'S ATTENTION AN UNDERSTANDING OF THE AVAILABILITY ISSUE. AS AN INDEPENDENT AGENT, I WEAR TWO HATS; ONE BEING AS A MEMBER OF THE INSURANCE INDUSTRY REPRESENTING SEVERAL COMPANIES, AND THE OTHER AS A AGENT FOR OUR CLIENTS, THE CONSUMER. MY JOB AS AN AGENT IS TO FIND COVERAGE MY CLIENTS NEED TO STAY IN BUSINESS AND HELP FIND A WAY OUT OF THE AVAILABILITY CRISIS. TO DO THIS, I'D LIKE TO OFFER A FEW GENERAL OBSERVATIONS ON INSURANCE AVAILABILITY, SOME SUGGESTIONS ON HOW TO IMPROVE IT AND THEN ANSWER ANY QUESTIONS.

WHY IS THERE AN AVAILABILITY CRISIS?

TO UNDERSTAND AVAILABILITY, IT HELPS TO UNDERSTAND INSURANCE: WHAT IT IS, HOW IT WORKS, AND HOW IT IS REGULATED. MARKET AVAILABILITY IS NOT UNCOMMON IN THE MARKET PLACE, PROFITS AND LOSSES ARE THE FEATURES THAT CONSTANTLY CHANGE THAT AVAILABILITY.

WE'RE ALL FAMILIAR WITH THE UNIQUE NATURE OF INSURANCE - COMPANIES ASSESS RISK, PREDICT FUTURE LOSSES, AND RESERVE AGAINST THOSE LOSSESS - AND THESE COMPANIES RELY ON CONTRACTUAL CERTAINTY, ECONOMIC STABILITY, AND THE LAW OF LARGE NUMBERS. IT IS ALSO USEFUL

TO REMIND OURSELVES THAT INSURORS ARE IN THE BUSINESS OF RISK TAKING TO MAKE, NOT LOSE MONEY. AS A HIGHLY COMPETITIVE, AND UNTIL RECENTLY, PROFITABLE BUSINESS. NO ONE SHOULD BEGRUDGE THE INDUSTRY THE BUSINESS DECISIONS AND MARKETING JUDGEMENTS NECESSARY TO ENSURE PROFITABILITY.

TO A LARGE DEGREE, THE DECISIONS NOW BEING MADE, AND THE STRAIN ON AVAILABILITY AND AFFORDABILITY NOW BEING FELT, REFLECT FORCES BEYOND THE INDUSTRY'S CONTROL. THERE HAS BEEN A DRAMATIC DECREASE IN INTEREST RATES OVER THE PAST FIVE YEARS, RESULTING IN A SEVERE LOSS IN PLANNED INVESTMENT INCOME, AND, IN SOME SPECIALITY LINES NOW IN THE NEWS, THERE HAVE BEEN HUGE LOSSES SIMPLY BEYOND THE CAPACITY OF THE INDUSTRY TO ABSORB. TORT LITIGATION, DECREASE OF INVESTMENT INCOME, AND RECORD LOSSES AND SETTLEMENT COSTS, TELL A LARGE PART OF THE AVAILABILITY STORY.

STATE REGULATION

ANOTHER PART OF THE STORY OF INSURANCE AVAILABILITY IS STATE REGULATION. ALTHOUGH A MEMBER IN GOOD STANDING OF THE FREE MARKET THE INSURANCE INDUSTRY, IS ALREADY HIGHLY REGULATED.

DEPENDING UPON THE STATE, SUCH CHOICES AS WHERE AND HOW TO INVEST MONEY, HOW TO PRICE A POLICY, AND HOW MUCH TO RESERVE AGAINST LOSSES AND INSOLVENCY ARE SCRUTINIZED AND SOMETIMES CONSTRAINED BY REGULATION. IN ALL STATES, INSURANCE COMMISSIONERS ARE CHARGED WITH SEEING TO IT THAT INSURANCE PRICING IS NOT INADEQUATE, EXCESSIVE, OR UNFAIRLY DISCRIMINATORY. AN IMPORTANT POINT, AND SOMETHING TO KEEP IN MIND, IS THAT INSURANCE REGULATORS HAVE THE AUTHORITY TO PROTECT THE INDUSTRY FROM ITSELF AND THE PUBLIC FROM INADEQUATE RESERVES AND CAPACITY SHOULD INSURERS PRICE POLICIES TOO LOW.

INSURANCE COMPANY BEHAVIOR

THERE IS A THIRD PART TO THIS STORY. A COMPONENT OF THE AVAILABILITY AND AFFORDABILITY OF INSURANCE WHICH IS WITHIN THE INDUSTRY'S POWER TO CONTROL.

SEVERLY COMPETITIVE UNDERPRICING WHEN TIMES WERE GOOD FOLLOWED BY ILL-CONCEIVED EFFORTS TO MAKE UP LOST GROUND TOO QUICKLY, ALMOST CERTAINLY HAVE MADE A BAD SITUATION WORSE. ANOTHER REACTION BY THE INSURANCE INDUSTRY IS TO TREAT ALL TYPES OF RISK THE SAME, TO CLASS UNDERWRITE. IT IS CLEAR THAT INSURORS ARE ATTEMPTING TO FIND A WAY TO GET OUT OF WRITING A NEW PIECE OF BUSINESS IN THE CURRENT MARKET.

MR. CHAIRMAN, THAT, BRIEFLY, IS THE STORY AS AN INSURANCE AGENT WOULD TELL IT: AN INDUSTRY UNIQUE IN FUNCTION AND CYCLICAL IN NATURE, WHICH HAS EXPERIENCED AN UNUSUALLY DAMAGING COMBINATION OF TORT TRENDS, ECONOMIC DEFLATION, AND RECORD LOSSES. GIVEN THESE OBSERVATIONS, WHAT CAN BE DONE TO RESTORE AVAILABILITY AND AFFORDABILITY TO INSURANCE MARKETS?

WHAT TO DO

(1) REASSESSAND REFORM TORT LAW. NO ISSUE IS MORE FUNDAMENTAL TO THE CURRENT INSURANCE CRISIS, NOR MORE TROUBLESOME TO THE PUBLIC'S SENSE OF FAIRNESS AND REASON, THAN THE EXPOLSION IN THIS COUNTRY OF LITIGATION, COURT DECREE, LIABILITY ASSESSMENT, JURY AWARDS, AND SETTLEMENT COSTS NOW ASSOCIATED WITH OUR TORT SYSYTEM. THIS IS NOT, A PROBLEM NECESSARILY THAT CONGRESS CAN SOLVE: SEVERAL AND GROWING NUMBERS OF STATE LEGISLATURES ARE ADOPTING TORT REFORMS WHICH MAY HELP NUDGE TORT TRENDS IN A LESS DAMAGING DIRECTION.

(2) STRENGTHEN STATE REGULATION. AS MENTIONED EARLIER IN MY

REMARKS, STATE REGULATORS HAVE THE AUTHORITY AND COMPETENCE TO ADDRESS MANY OF THE QUIRKS IN INDUSTRY BEHAVIOR (UNDERPRICING, OVER-PRICING, OVERBOARD APPLICATION OF DEFENSIVE STRATEGIES TO RISKS NOT SERIOUSLY AFFECTED). THESE REGULATORS SHOULD BE SUPPORTED BY AGENT AND INDUSTRY GROUPS IN THEIR STATES, AND ENCOURAGED TO DESIGN AND IMPLEMENT REGULATIONS TO HELP ALLEVIATE THE AVAILABILITY CRUNCH.

(3) ALTERNATIVE MARKETING PLANS. WHERE LINES OF INSURANCE BECOME UNAVAILABLE OR UNAFFORDABLE IN CONVENTIONAL MARKETS, ALTER-NATIVE MARKETS SHOULD BE ESTABLISHED - AGAIN, STATE-BY-STATE, AND, WHERE POSSIBLE, BY VOLUNTARY PARTICIPATION. INSURANCE CARRIERS IN THE STATE VOLUNTEER TO REVIEW AND UNDERWRITE PROPOSALS FUNNELLED TO THEM THROUGH THE AGENTS' ASSOCIATION.

WHERE VOLUNTARY MARKET ASSISTANCE PLANS PROVE UNFEASIBLE, STATE REGULATORS CAN MANDATE JOINT UNDERWRITING ASSOCIATIONS, REQUIRING A GROUP OF CARRIERS TO UNDERWRITE AND SERVICE CERTAIN RISKS, AND THEN DIVIDING THE COST AMONG ALL OTHER CARRIERS WHICH OPERATE IN THE STATE.

(4) INTER-INDUSTRY TASK FORCES. EMPHASIZING VOLUNTARY, MARKET SOLUTIONS TO AVAILABILITY IS ALWAYS TO BE PREFERRED, AND AFFECTED INDUSTRIES AT THE LOCAL, STATE, AND NATIONAL LEVEL SHOULD BE ORGANIZED AND ENCOURAGED TO GET TOGETHER WITH EACH OTHER AND WITH INSURANCE AGENTS AND COMPANIES TO ASSESS MARKETS AND OFFER PROPOSALS FOR INCREASING AVAILABILITY AND REDUCING PRICE.

WHAT NOT TO DO

THE TEMPTATION FOR FEDERAL INTERVENTION WILL BE STRONG, BUT BASED ON PAST EXPERIENCE AND ON THE POSSIBILITY OF MAKING WORSE BY FEDERAL INTERFERENCE THE DISTORTIONS NOW PLAGUING LIABILITY MARKETS, IT SHOULD BE STRONGLY RESISTED.

(1) DO NOT FEDERALLY REGULATE INSURANCE. PROPONENTS OF FEDERAL REGULATION ARE LESS CONCERNED WITH INSURANCE AVAILABILITY THEN THEY ARE WITH THE ALLOCATION OF INSURANCE FUNDS IN WAYS THEY DEEM SOCIALLY OR POLITICALLY DESIRABLE. BY IMPOSING ADDITIONAL COSTS, CONSTRAINTS, INEFFICIENCIES, AND MARKET DISTORTIONS, FEDERAL REGULATION COULD BE EXPECTED TO MAKE MATTERS WORSE. STATE REGULATION IS FULLY UP TO THE TASK OF REGULATING FOR SOLVENCY, AVAILABILITY, AND AFFORDABILITY AND CAN BE MODIFIED OR ABANDONED WITHOUT AFFECTING THE ENTIRE INDUSTRY.

(2) DO NOT ESTABLISH FEDERAL INSURANCE PROGRAMS. WHILE ON THE SURFACE FEDERAL REINSURANCE OR DIRECT INSURANCE FOR COVERAGES OTHERWISE UNAVAILABLE SEEMS PLAUSIBLE, EXPERIENCE HAS SHOWN FEDERAL INSURANCE PROGRAMS DON'T DELIVER. FEDERAL CRIME, FLOOD, CROP AND NUCLEAR INSURANCE PROGRAMS - TO NAME ONLY THE MOST VISIBLE EXAMPLES - CONSISTENTLY LOSE MONEY, ARE PLAGUED BY OPERATING AND SERVICING INEFFICIENCIES, AND USUALLY END UP SERVING POLITICAL RATHER THAN ECONOMIC OR MARKET OBJECTIVES.

(3) DO NOT MANDATE INSURANCE COVERAGES OR LIABILITY LIMITS. HARD AS INSURANCE AVAILABILITY IS TO LIVE WITH, THERE ARE USUALLY MARKET REASONS TO ACCOUNT FOR THE CRUNCH. GOVERNMENT HAS NEVER BEEN GOOD AT REPEALING THE LAWS OF ECONOMICS, AND TO THE EXTENT COVERAGE IS MANDATED IT WILL BE AT TAYPAYER EXPENSE (SINCE THE MARKET HAS ALREADY DETERMINED IT CANNOT BE PROVIDED FOR A PROFIT). SIMILARLY, MANDATED LIABILITY LIMITS WHERE INSURANCE IS OTHERWISE AVAILABLE (MOTOR CARRIER ACT LIMITS FOR EXAMPLE) INJECT EXACTLY THE KINDS OF MARKET DISTORTION AND INCREASED PRICES THAT QUICKLY DRY UP WHATEVER COVERAGES MIGHT HAVE BEEN PURCHASED. TRUCK INSURANCE FOR EXAMPLE, IS NOT TODAY UNAVAILABLE, IT SIMPLY CAN'T BE AFFORDED AT THE ARTIFICIALLY HIGH LIABILITY LIMITS THE MOTOR CARRIER ACT HAS IMPOSED.

MR. CHAIRMAN, THAT CONCLUDES MY REMARKS. I WOULD BE HAPPY TO ANSWER YOUR QUESTIONS AND HOPE THAT INFORMATION I'VE PROVIDED WILL HELP YOUR SUBCOMMITTEE UNDERSTAND THE AVAILABILITY CRISIS. THANK YOU!!!

Senator PRESSLER. Well, I thank you both for your expertise.

Now, I take it that this panel, both of you, take a dim view of Federal involvement. And I would predict that the Federal Government will wait until the State legislatures meet this year before doing anything. Nearly all State legislatures begin in January. Ours goes for a couple of months; some go for 6 months. Some State legislatures go year-round.

First of all, I have a two-part question to both of you.

I take it you would disagree with some of the earlier witnesses in that you would not be supporters of S. 1804 or of the product liability bill on a Federal basis at this point? I may be stating your position incorrectly, but comment on that.

And then comment on what steps you feel that State legislatures, in particular the South Dakota State Legislature, will probably take. I know you've already mentioned some legislation that you will be proposing. But what can we expect will happen that will alleviate this problem to some extent? And you can take into consideration that the insurance industry is cyclical and so forth. Could you please deal with those two questions, one Federal and one State.

Ms. WALKER. I hoped you would comment on 1804 first—go ahead.

Mr. LARSEN. S. 1804, Larry—I'm sorry——

Senator PRESSLER. I'm thinking I'm back in Washington inside the beltway talking about these bills. S. 1804 is Senator Hatch's bill that in this area would limit punitive damages to $250,000—not medical recovery, not career recoveries. But the idea—aside from 1804, because it will be changed a lot and amended a lot if it ever does move—but the concept of federally-imposed limitations on recovery would be the idea. The second idea—and I take it from your statement you would be opposed to the Federal Government getting involved at this time?

Mr. LARSEN. Yes.

Senator PRESSLER. The other proposed legislation is a product liability or kind of a uniform standard—whether it's for products or cities or whatever, the concept is that we would have a more uniform Federal standard for negligence so you wouldn't have so much forum shopping and so forth. But I gather—and indeed, you did say in your statement you thought the Federal Government should hold off at this time until the State legislatures meet and private voluntary activity has occurred. Is that right?

Mr. LARSEN. Yes, Larry. I think that you're going to see much activity all across the country going on in the State legislatures and you're going to see a variety of legislation that's going to come in. Some is going to make sense and some is not going to, and we cannot legislate totally the problems. I think that we have to identify them on a State level. Like I mentioned in my comments, this thing is very cyclical and it's here today. And we've been charging a dime when we needed 80 cents. And it goes around, and in a very short period we'll be back on the other side of the cycle and all these matters are meaningless at this point in time.

I do not agree with Federal legislation. I think we have to deal with it—we have to deal with it on the State level. Prime examples of areas that I truly believe we should look into is reimbursement

from the plaintiff or the plaintiff's attorney for frivolous lawsuits, and that would eliminate a high degree of the lawsuits that we're presently and currently involved in.

In the product liability area we do have a law currently on the books, but it's a watered down law. We need to redo that. The original bill that went in, as I recall it—and that's been done some time ago—was not watered down. It was very decisive. If a wholesaler does nothing more than pass the product through his doors or a retailer does nothing more and doesn't change it, the liability passes directly to the manufacturer. And it eliminates two or three more individuals or corporations that no longer have to be involved in a suit. There are areas as such. And I'll turn it over to Susan.

Ms. WALKER. Thank you.

Senator Pressler, you've prefaced every one of your own remarks that you're a States 'rightist, and I agree with this and I agree that maybe Federal legislation in this particular area may be premature. The problem that I have when you look at any type of Federal legislation, and you're putting a cap of $250,000 in punitive damages—that becomes the cap; then does it also become the limit? Whereas, you would not be seeing courts looking at maybe the imposition of punitive damages, now we see a Federal law of $250,000.

What we have to do—and it's up to each State and I think it's up to the bar association of each State—is to take a good, hard look at the facts. Let's not impose punitive damages where they are not warranted. It's become too free and easy. It should only be in those particular limited instances where there is malicious and willful conduct on the part of the defendant. And this is the problem that we're seeing all across the Nation.

It's a great bargaining chip. The compensatory damages can be minimal. And I've seen many lawsuits filed for, let's say, $50,000 compensatory damages, punitive damages of $3 million. This is what we're looking at. I'm not so sure—a cap, yes, might address the problem in certain jurisdictions.

I don't think we have a problem in South Dakota on punitive damage awards. And again, I think South Dakota is brought in with the national trend. And I just think that it's hard, because any time you look at Federal legislation, we still are looking at 50 States and how do those particular judges interpret that particular law? And you can see it with our congressional acts such as the Comprehensive Environmental Responsibility Compensation and Liability Act of 1980. Look at what that did to toxic waste cleanup. Look at the liability that particular congressional act has imposed in the commercial lines.

Now, you talk about any type of Federal act and, again, how is that particular act interpreted by the various 50 States' jurisdictions, because you can't—you can't go and stringently define—if Congress can come up with a bill where everyone will interpret it uniformly, I say that's great and hats off to you if you can do it. But I've never yet seen any type of Federal legislation that's been uniformly interpreted. And that's the problem you're facing.

Senator PRESSLER. What do you expect the State legislature to do in this area? Most States aren't limiting punitive damages. I think some States have started to, but—I don't know if you have any comment.

I should also explain the charts up here. The first one shows the insurance industry's pretax operating income over the last 18 years. Pretax operating income is investment income minus underwriting losses. You can clearly see the cyclical nature of the industry. The second chart shows even better how the industry got to where it is now. As you can see, investment income—the dashed line—has been steadily increasing over the past 15 to 18 years. Underwriting income, on the other hand, has fluctuated during that same period except for the past several years. During that time the insurance industry has lost more and more money evey year in its underwriting business. Could you comment on these charts?

Mr. LARSEN. I can—I think Susan has already covered a lot of those numbers there, Larry. The problem right now—I just got the third-quarter report. Last year the underwriting loss for the entire industry for the property and casualty industry was $21 billion. This year through 9 months the underwriting loss is $15.7 billion, and it's anticipated that it's going to reach the $21 billion level, plus or minus.

And so—and that's essentially what those charts are showing you, is where the investment income back in 1984 could no longer keep pace with underwriting loss.

We were in a "cash flow mode" through the 1980's. And if you go back to 1974 and 1975, we have the same situation where the same cycle came around and we saw the prices accelerate. I can tell you that we have accounts that the premiums that we charged in 1977 and in 1978, 1985 prices are not—we're not back to those premiums in 1985. We're still probably 30, 40 percent less, so there's some room to grow.

Senator PRESSLER. Thank you both very much.

At this point I was going to open it up. I know that Ross Rinehart is here from South Dakota Manufacturing. I know Bud Walling from Walling Chemical has something. I wonder if I could ask those folks to do it in writing, for this reason: Someone else has a claim on this room at 12:30. I understand—and I do want to do some wrap-up here, but I want to thank our witnesses very much.[1]

These hearings will be continuing in Rapid City, where we'll hear from the South Dakota Bar Association. We will also be hearing from additional businessmen in the western part of the State later on; a week from today, in fact. I think the high cost and scarcity of insurance is a crisis which we have to deal with. It's going to take, I think, a combination of State and Federal actions. I'm presently cosponsor of two pieces of Federal legislation, but it may well be that our State legislatures will act in such a fashion in the early months that those bills will be unnecessary.

But all that being said, I want to thank the witnesses who came here this morning. I want to thank the people who traveled a great distance, and the State legislators who are here. It's been very useful to me. We'll provide the transcript to both the Commerce Committee and the Small Business Committee.

And with that, I conclude this hearing. Thank you very much.

[Whereupon, at 12:05 p.m., the hearing was recessed, to reconvene at the call of the Chair.]

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[1] Material not available at time of going to press.

THE COST AND AVAILABILITY OF LIABILITY INSURANCE FOR SMALL BUSINESS

MONDAY, DECEMBER 30, 1985

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS
Rapid City, SD.

The committee met, pursuant to recess, at 10 a.m., in the Lincoln Room, Alex Johnson Hotel, Rapid City, SD, Senator Larry Pressler (acting chairman) presiding.

Present: Senator Pressler.

Staff present: Kevin Schieffer, staff of Senator Pressler.

STATEMENT OF HON. LARRY PRESSLER, A U.S. SENATOR FROM THE STATE OF SOUTH DAKOTA, AND ACTING CHAIRMAN, COMMITTEE ON SMALL BUSINESS

Senator PRESSLER. First of all, thank you very much for being here. We are bringing more chairs in and there is additional room here. There are more chairs available, so everybody is welcome. There is coffee in the back of the room.

We are going to be moving right along this morning. I am going to make an opening statement first, so I call this hearing to order, and I thank you for being here.

I see a lot of familiar faces, many of whom should be introduced, but I think we will move right along.

To get to the background of this hearing, there is a crisis in insurance rates and insurance coverage in this country and it has evolved, it seems from three things: one, the large recoveries in punitive damages that have been occurring across the country; two, the large number of lawsuits and exercising of individual rights by American citizens—which they have every right to do—but those citizens are only getting about 33 cents of recovery on these huge recoveries that we read about; and number three, the insurance industry seems to be somewhat cyclical and some say they made some unwise investments in the late seventies.

But be that as it may, the purpose of this hearing is to take back to Washington some specific examples and the ideas at a grassroots level.

We held a similar hearing in Sioux Falls about a week ago and I was amazed at the turnout. Also, I placed in one of my newsletters a questionnaire for the public to express what has happened to their insurance in the last few years, be it car insurance or be it a doctor's liability insurance or be it a trucker's insurance, to try to

get insurance, and increasingly many of our small businesses cannot get insurance or have to pay really high rates.

We had one business in the Sioux Falls area that testified they had not been able to obtain insurance for the coming year and they are a major employer in this State, and that is Raven Industries. So there is a problem.

Now, historically, insurance regulation and insurance matters have been left to the States under the McCarran-Ferguson Act of 1945 as amended in 1948. The Federal Government looks upon it as a matter of interstate commerce to be decided by the individual States, and that is probably where it should be. If the Federal Government were to enter the area, it would be an area of unprecedented Federal regulation, so to speak, but there is such an outcry that unless the State legislators do something in January, February, and March, that we will be in a very difficult situation because there is such an outcry from across the country.

There are three pieces of Federal—well, two main pieces of Federal legislation that have been introduced. One is by Senator Hatch which would limit punitive damages to $250,000 in many cases; that is, a plaintiff could recover for medical expenses for their loss, but in terms of punitive damages it would be a $250,000 limitation.

Some consumer groups, like Ralph Nader, feel this is not good because they say the only way that General Motors or some big corporation can be made to meet safety standards and so forth is to pay very severe punitive damages. It is my feeling that maybe punitive damages set at that level for the first occurrence, and perhaps higher the second time, if it ever occurred again—that would be a way of solving that problem.

A second piece of legislation has been introduced by Senator Kasten of Wisconsin and myself, and it did fail in the Commerce Committee once; we had a tie vote on it. That piece of legislation would move toward a uniform standard of product liability so that you wouldn't have the forum shopping, where right now, if you have a suit against an interstate company, you will probably move it to New Jersey or California where there is a higher recovery standard. But this would mean that plaintiffs could recover much more quickly and there wouldn't be so much forum shopping and there would be a uniform standard.

Now again, that is Federal regulation, which I am generally against. And I hope we can resolve this problem; I hope we find that insurance is a cyclical thing. But there is such an outcry from the public that something will have to be done.

Let me also say that I think this is the No. 1 consumer issue of the 1980's because people end up paying for this which, in turn, they pass on to the consumer in the form of more expensive products. And really, when a corporation or a doctor or anybody has higher liability rates, they are going to have to pass the charges on if they are going to stay in business. And there is nothing wrong with making a profit, but if businesses don't make a profit they won't stay in business or go in business. So actually, every consumer has an interest in this.

Let me say that a lot of victims, a lot of the lawsuits that you read about where there is a big recovery, only 33 cents on the dollar usually gets to the victim and it's 5 to 6 years at the earliest.

So we are in a situation where we must consider legal reform, tort reform, where we must consider some limitation at the State level and Federal level, and States such as South Dakota finds itself paying for other States' sins, so to speak, because our State has not—our juries and awards have not been excessive.

I think when someone is wrong they should recover, but some of the punitive damages have reached a point where the public ends up paying for them. Well, I suppose most juries or people think the company has insurance anyway, what difference does it make, and it does make a difference because the public ends up paying for it.

Also, the creation of jobs—if small business, truckers and other small businesses can't get insurance, then it hurts jobs. One thing we may be seeing in this coming year is for certain well-off groups forming together, forming group insurance. That will make it even tougher for the independent businessman to become involved.

I work a great deal with the National Federation of Businessmen, which I think is a fine lobby group, and there is nothing wrong with that word in its best sense when it is used in its best sense; but they are very concerned about what is happening to small businesses around the country in this area.

In Sioux Falls we heard from the Medical Association, the South Dakota Insurance Division—very fine testimony from Susan Walker—the trucking industry, and the insurance industry. Today we will continue, and we are building a record here, the small business economy, with tourism, day care centers, South Dakota Bar Association, and the insurance industry.

Let me say it isn't just business. The day care centers or anybody trying to provide service, nursing homes for the elderly—all these groups have found a very difficult time.

I think I have covered some of the highlights previously. I might point out a major South Dakota bus company has had to reduce services in part because its insurance premiums increased over—so dramatically.

For example, loggers and truckers have had huge increases in their insurance, and in some cases couldn't find anyone to insure them. Small businesses of all types are faced with the prospect of paying drastically higher premiums or, in some cases, doing without insurance or going out of business. Doctors are being literally driven out of business. Cities are being forced to terminate essential services, and States are struggling with this. Consumers have to pay for this increase through higher product costs and service costs.

As I mentioned, there have been insurance buyers and sellers alike that have called for various types of tort reform. Substantive and procedural limitations of recovery, including statute of limitations and punitive damages limits, tougher standards for proving intent or justifiable lawsuits and for more elimination of frivolous lawsuits, limits on or disclosures of lawyer's fees, awarding stronger sovereign immunity, for example, and a host of others.

As I mentioned, I have been a strong cosponsor of the product liability bill, which would establish a uniform code; but that, again, is something that would run far short, so to speak, of the McCarran-Ferguson Act of 1945, which delegated the States regulatory authority over the insurance industries and related matters by

making authorities leave these kinds of issues to the States. And indeed, I am generally against any Federal intervention, but this problem seems to be transgressing to State boards.

Rates no longer appear to be set on a State-by-State basis, and it's unclear to me to what extent they are regulated by individual State commerce, which they really have no choice if they want their people in their State to have insurance.

So with that summary, I will begin the hearing. I wanted to mention just a few people who are here. Darrell Sawyer from my Rapid City office is here somewhere. There he is, right there. He is the man to call or see when I am not here; he does a terrific job for me.

Mary Pechin, who works with him, is back there and if anybody has a case that they want me to work on on some individual matter, they could see them during the hearing.d I think Mary will be back here and can get your phone number or I can call you.

I have to be on KOTA at 12 noon, so I am going to move this hearing right along. I wanted to identify also, Rick Sloan is a volunteer in our office. We are always glad to have a volunteer. Nancy Carlson is home for Christmas and is here. Very glad to see her. And Kevin Schieffer, who is an expert on these matters with the Commerce Committee, is here.

Let me begin by calling our first witness. I should say there are a number of dignitaries here and there is always the great mistake because I will miss somebody. John Sears, who will be dealing with this issue in the State legislation is here, State representative, and also Bob Helmer, the former mayor of Belle Fourche is here, two good friends; if they would just wave their hands. I probably missed some, but send your name up and I will introduce you.

First of all, I want to call on Don Shultz, on behalf of Terry Peak Ski Lodge, from which I have come; and I might add, I don't have any suit to file, but I skied for several days up there and it's really great. The conditions are just really great. My wife and I had a terrific time; we've spent several years up at Terry Peak at Christmas time, and we did this year.

Also, Bill Honnerkamp from the Black Hills, Badlands and Lakes Association will be on our first panel. We were scheduled to hear from Mayor LaCroix but he was unable to attend, but will be sending Ray Woodsend, my classmate from USD. But let's hear from Don Shultz and Bill Honnerkamp, and then we will hear from Ray Woodsend.

Then we will hear from Ken Lee of Pope & Talbot in Spearfish; Cheryl Herbst, director of the Black Hills Preschool and Child Care Center in Deadwood; and then Mr. Gary Jensen from the South Dakota Bar Association and Dale Yeoman from Kluthe & Lane Insurance Agency; and Chris Schmid, president of the South Dakota Independent Insurance Agency and president of Schmid Insurance Agency in Rapid City.

We asked our witnesses to summarize their statements. We have put the entire written statements in the record for the benefit of the committee in Washington, and we asked that each witness speak from 5 to 8 minutes and to place their statements in the record, and to respond to questions.

Also, other Senators may wish to submit written questions and we supply those to the witnesses later on specifics.

So with that, I call forward Mr. Don Shultz on behalf of Terry Peak Ski Resort and Bill Honnerkamp on behalf of the Black Hills Badlands and Lakes Association, Rapid City.

We will move the microphone over here so you can hear them clearly.

Don, you can proceed.

STATEMENT OF DON SHULTZ, ON BEHALF OF TERRY PEAK SKI RESORT

Mr. SHULTZ. Thank you.

Senator PRESSLER. That's all right; you can sit there and they can hear.

Mr. SHULTZ. First of all, we want to thank you, Senator Pressler, for coming to South Dakota and addressing this need that our citizens find themselves in.

Second, we are glad that you are able to come out and ski at Terry Peak because we think we have one of the best seasons going that we have ever had going.

As you can tell, we have spent—we have a large capital outlay that we did this year to improve the area, and we plan to continue that; and one of the problems, of course, is insurance rates.

We pride ourselves at Terry Peak as being a very safe family area, and in the past—I can recall in the last 10 years, only one lawsuit. That lawsuit was settled for a very nominal amount, but our insurance rates rose where we are now paying $95,000 a year.

Now, that includes some things other than liability insurance. We have substantial property and other things up there that are included in those rates, but we think the problem is that South Dakota is paying—as you mentioned, Senator—for somebody else's mistakes.

I was personally—our firm was personally involved. We represented two of the injured people in the Vail gondola accident, and I can tell you that the Vail gondola accident was not an accident. It was brought because there was falsification of records. There was an attempt on behalf of the corporation running the Vail gondola that fell, to minimize their upkeep expense. They did not replace the cable when they were supposed to. There was some falsifying of records for State agents, so not only is the consumer paying an enormous amount of premium, but I also think that the consumer is not getting their money's worth as far as the protection.

So my suggestion would be, Senator Pressler, that before you adopt Federal legislation, that the State legislature should really look into what's happening in businesses as far as the premiums. Why should Terry Peak, who has only had a minimal loss record—I think our total outpay in claims was $5,000—why should we be paying an enormous premium, which apparently is paying for somebody else's mistakes and culpable mistakes?

So I would suggest that the State legislature, rather than arbitrarily taking away from citizens their protective rights, their rights and their protection, that the State legislature should look into how these rates are being set. Why are we getting such tremendous increases in South Dakota where we do not have the large amount of litigation which other States may or may not

have? And you suggested that 33 cents of the premium dollar is actually going to the victim; is that the way I understand?

Senator PRESSLER. That's the information that I have.

Mr. SHULTZ. I don't know what part of that premium dollar is being spent for the insurance services, for the inspection services, the engineering services that should be provided to make sure that consumers are being protected on the slopes.

So far as Terry Peak is concerned, our position would be that we would like to see the State legislature look into insurance rates, find out why insurance companies are having to charge these increased rates in South Dakota where there is just not the claim frequency or the large verdicts or, for that matter, Senator Pressler, punitive damages.

I have represented insurance companies for 30 years. I know personally most of the insurance men in this room; they are very dedicated insurance people. They have the problem of protecting the consumer, protecting their customers, and I think they would also like and welcome a study to determine what the loss frequency and loss rates of South Dakota are as compared to other States.

That's the end of my prepared remarks. Thank you.

Senator PRESSLER. Do we have Bill Honnerkamp here? Maybe he is not here yet.

Ray Woodsend, why don't you come forward and give your testimony.

We welcome you, and nice to see you again. We spent a lot of time down at the University of South Dakota. I'm always glad to hear from you.

STATEMENT OF RAY WOODSEND, REPRESENTING THE MAYOR OF RAPID CITY, SD

Mr. WOODSEND. Yes, I am glad to be here on behalf of Mayor Art LaCroix.

I think there is a little framework background. The city's experience, first of all, in the last year is that the city's premiums increased from just a little over $200,000 January 1, 1985 to the vicinity of $950,000.

We were able, in late February, to find another carrier and for the year of 1985 ended up at about $740,000 in insurance costs. Fortunately, we were able to buy it.

I also wear another hat at times, president of the Municipal League, and there are many communities out there—particularly the small towns—that are unable to find insurance.

I think that we have to keep in mind that there is a difference between the temporary and long-range problems. I think that if you look back in history, part of the problem today is of a temporary nature and I think personally has been brought on by the investment practices of some of the insurance companies.

There is truly a shortage, I think, of capitalization for insurance companies; but that is, I think, only on a temporary basis. I don't think the problem has been brought about by large judgments.

You look in the municipal area, particularly. I believe there are only nationwide about three judgments in excess of $1 million against cities; and yet when you look at the rates that are being

charged, at least on the temporary basis, I think we have to look at the long range as far as the goal.

I think the temporary solution is going to have to be sought out, maybe by some entities, like cities possibly joining together and forming some mutual insurance companies, if for no other reason than to raise the capital some way to get coverage.

One area that is a particular concern to cities throughout the country has to do with the unavailability of finding coverage concerning landfills and that type of problem. I think we are going to see many cities getting out of the sanitary landfill business, and that creates a very serious problem as they get out because they can't buy coverage to protect them from problems that may eventually evolve from operating a landfill.

I do have one further comment in looking back in my notes. In Rapid City, with that $750,000 a year, that is one-sixth of all property taxes the city collects are going to pay insurance premiums.

Senator PRESSLER. Don, you made a very good point, that South Dakota is sort of visited by the sins of others, so to speak; or in your own case at Terry Peak, we haven't had the kind of claims or problems that have occurred in other areas.

It seems that the insurance industry is regulated on a State-by-State basis, but as a practical matter a State commission doesn't have any choice. If the people in that State are going to have insurance, if the companies write it at any rate they probably have to more or less go along.

Would you like to see Federal legislation asking for a uniform product liability law?

Mr. SHULTZ. You know, you and I have discussed the product liability law for a long time and I have not had, really, an in-depth study of the latest product liability law which is being proposed.

I think the problem that we see as far as South Dakota is that before we had the product liability laws and basically the "long arm" statutes allowing a South Dakota citizen who had been hurt to sue a company based out of California in South Dakota, that the consumer had no protection.

When that started, the consumer being able to sue a manufacturer where he is injured, then I think you found that manufacturers were much more careful in manufacturing their products. And I would hate to see that concept change, that the citizen would have to go to California to sue that manufacturer rather than make the manufacturer responsible to respond in South Dakota to injuries that occurred in South Dakota. And I'm not familiar enough with your bill to determine how that would be handled. To me, that would be the main concern that I would have.

Senator PRESSLER. Ray, at the hearing in Sioux Falls last week Bob Miller of the Municipal League, of which you have testified Rapid City increased by over 1,200 percent, which I think you have repeated—what is the reason given to you for the increase? And how significant an impact does this have on the city's overall budget?

Mr. WOODSEND. It was a significant increase. That 1,200 percent was just in our umbrella policy alone; went from about $9,000 to $170,000, and it was for a million dollars less than the previous one.

The problem that the city had is we were given no explanation, because the company we were insured with went out of the business and we were forced to find a new carrier. And so the new carriers—like I say, the one in January that we—we looked and looked and found one carrier January 1, and they wanted a premium charge of $950,000 for the year. And fortunately, our agents kept working and we were able to secure one for about $750,000; but like I say, that's one sixth of all the property taxes collected just to pay insurance, and that's a very substantial portion of the property tax dollar.

So you know who is paying for it. It's taxpayers out there paying it, and the consumers. I don't know about—as far as the city—on product liability.

The one thought I do have is whether or not there is—I think if an investigation was done thoroughly that you would find a lot of the problem had to do with the investment practices of a lot of the insurance companies.

Actually, the city and a lot of us in the room probably benefited in a few years by substandardly low premium dollars because the insurance companies were out there trying to get the premium dollar so they could invest it and hopefully make big money off the investments, and they were not realistic. But that has created the problem, which simply is that there isn't—so many have gone out of the business entirely that there is not sufficient capital in the industry to finance everybody that needs insurance, and that's a twofold process.

One, availability, and the other is lack of competition, and unless we get that capitalization back up, whether it's on a short-term basis—I have had some discussion with people from the State legislature, but we can't just stand by. We should do some sort of limitation for a couple of years to handle the temporary problem.

But I think it's long range. We have to see that this type of investment practice, this type of premium charging that allows them to basically break themselves, stops in some way. I don't think the individual States can necessarily do that. I don't know but that we need some sort of uniform guidelines where the States could have stricter guidance if they wanted, but some possibly national basis for establishing the capitalization rate that would be necessary and possibly premium charges of some sort in relation to the dollars of loss.

Senator PRESSLER. I think the summary you have just given is excellent. By the way, the Commerce, Science, and Transportation Committee has sent a formal request to the insurance companies to present information by February 15 along the lines that you have suggested.

How much of this thing is a cyclical thing? How much is a result of unwise investment by the insurance companies and at higher risk than they normally invest in, like the late 1970's, which is a very American thing to do? But it would probably be a higher risk sort of thing than we would normally expect them to invest in, but those are decisions that have been made and some have argued before this committee that this is a cyclical thing. It's going to work its way out in a year or two and if the Federal Government

rushes in with regulation, it will be more regulation and counterproductive.

However, we did have some mayors before the Commerce Committee from the State of Maryland who said they would no longer serve as mayors if this trend continues because they would be held personally liable for things they cannot insure themselves for, and cannot afford to. They are just citizen mayors of small towns.

What effect will this have of people being ambulance attendants, policemen? And there are mistakes made in all areas of life, some of which are unintentional, but are interpreted as intentional acts afterward or negligence, where it wasn't. It wasn't negligence.

How will this affect municipal employees if it is carried out to this degree?

Mr. WOODSEND. Obviously, the municipal employee is affected if the city is unable to buy insurance. The mayor and city council are almost forced in South Dakota into a position that regardless of the cost, they have to buy it because you have at least one case that said if you didn't buy it, then the county could be held liable—or the commissioners—for not buying the insurance.

So you are caught. Either you pay the price that is being asked or you look at individual liability. And then you have those situations where the city just plain can't buy it, regardless of price, and those leave the cities in a very—and employees—in a very dangerous situation from performing anything. And you'll see police chiefs parking in the patrol cars except for absolute emergencies because those employees can't be expected to take that upon themselves as part of their employment.

I personally don't think sovereign immunity is the situation for municipal governments or State governments.

I have a strong personal conviction that the king can do wrong occasionally, and I don't think it is fair to say that if somebody is injured they can't recover just because it happens to be by the king, and the basis of sovereign immunity necessarily makes it right as to that person.

On the amount of that recovery, I don't have a problem with looking at some reasonable limitations, possibly, on the amount of recovery. I don't think, as an organization, the Municipal League supports absolute immunity for cities, counties and States because, like I say, if somebody gets injured, somebody has to pay. It is going to be the individual.

If the king does—or if the Federal Government does, and the State through its welfare claims and that type of thing—it's a question of who pays. And I think the ones that injure, legitimately injures somebody should pay. How much, is the question.

Senator PRESSLER. I certainly think that is a good analysis.

Let me say that Ralph Nader appeared before our committee with his group and said that—and I will give this to you as a question—he said the only way a grieved citizen who has a car accident which is the fault of the manufacturer—Ralph Nader talking—is to go to a lawyer or law firm on a contingency fee, because they can't afford to hire a lawyer; and the only way a law firm can take on General Motors is with a very high contingency because it will probably take them 4 or 5 years to sue them, and that is the only way General Motors can be held accountable.

What is each of your reactions to that?

Mr. SHULTZ. I'll comment first. I think the record shows that that's probably exactly what happened, that until the victims were able to get the engineering advice and the testimony—the expert testimony—that was needed, and some of it was done through Federal safety programs which prove that cars actually were unsafe, that the Corvair was actually an unsafe car—if that wouldn't have been done by the Federal Government, which was basically brought about through consumer litigation, there would have never been any compensation for those victims who were injured in the Corvair automobile.

So I would think that before you did away with the fault system completely—they call it tort reform, and tort reform to me, when I hear it, looks to me like they want to turn torts into a workman's compensation schedule and schedule your injury. To me, that would be an inappropriate answer and something that a citizen really doesn't want.d I don't think the insurance industry really wants that. I think it's a— it would be a quick cure, but it would be a drastic result for the people of this country if that happened.

Senator PRESSLER. The people in the back are signaling they can't quite hear, so I am going to have the witness pick up the microphone and hold it close.

In terms of—you have stated the sovereign immunity question very well, in that the king can do wrong sometimes. We have even had one Senator sued successfully for things he said off the Senate floor. You can't be sued for things you say on the Senate floor.

Mr. WOODSEND. That's unfortunate.

Senator PRESSLER. But I haven't been sued yet. In any event, any public official can be sued separately, as I understand it. That's what these mayors were saying, and they were saying they are just ordinary citizens serving part-time as mayors and weren't going to take that liability. Are we at that level in this State?

Mr. WOODSEND. I think we have some cities in this State that are very much in that position, that you just simply can't buy insurance, adequate limits of insurance, and I mean that was one of the problems Rapid City faced realistically this year, was whether or not we went for a while with only $1 million worth of coverage; and it's pretty tough as city attorney to sit there and advise the mayor and city council to stay on the job with that kind of limits of liability.

Fortunately we were able to find the umbrella carrier, but availability and the amount of availability is a very real problem. And when you do have that potential for that, for the lawsuit that may in fact be $1 million plus, and if a city can only acquire $500,000, that just isn't adequate limits. And so you are finding that in government, in South Dakota at this point, people are reluctant to take the jobs, and particularly if they have any sort of personal assets at all. And that really changes the scope of who can serve and who will serve on local government.

Senator PRESSLER. My last question is, what legislative steps would you like to see taken by the State or Federal Government in the near future, if any?

Let me say that one of the bills proposed $250,000 limitation on punitive damages. There might be a constitutional question for the

Federal Government to do that in the sense that there is a guarantee to a right to trial by jury in the Constitution. And most of the recoveries have been set by juries, and this is traditionally a State and local matter. But in any event, what legislative remedies, if any, on the part of the State and Federal Government would you recommend?

Mr. SCHULTZ. First of all, on the punitive damages, Senator Pressler, I can assure you that so far as I know we have never had a punitive damages award anywhere close to $250,000; say, nothing about $100,000. And the second part of your question, as far as other than the Governor suing—and he, of course, hasn't recovered for any punitive damages.

The second part of your question, as far as legislative activity—for the short run, what we would like to see—I will repeat what I said before—is intensive study on the part of our legislature to determine just what the problem is as far as the insurance companies.

Is there poor investment management? Were they giving away the insurance at a far too low premium, and how they hare having to play catch up for, say, 5 or 10 years of bad management by charging tremendous premiums in one year? So that's, I guess, what I would like to see done on the State level in this legislature.

Mr. WOODSEND. I guess my only difference with Don, a little bit, is I would like to see—is, I think, the legislature in South Dakota is going to have to look at some possible temporary limits on liability amounts, particularly as to cities, just because of availability.

I do think the capitalization issue and investment policies maybe have to be looked at on a national level to set some minimal Federal guidelines so that States could have stricter actions, but that we don't leave it up to States because I'm not sure States like South Dakota really have the capability to analyze and look at every insurance company that wishes to do business here. But if you had some minimal Federal control where the State could have more stringent basis, I think that might possibly be the answer in the area of investment practices and capitalization.

I do think that possibly some limits under the 1983 type action might be possible, however, o a Federal basis. And that is where some of the large suits, at least, are brought.

Senator PRESSLER. We thank you very much. I want to thank you both very much for taking the time to come.

We will call for Janice Crangle, administrator of the Black Hills Preschool and Child Care Center in Deadwood and Cheryl Herbst, director, to also come forward, and then we will hear from Ken Lee from the timber industry, from Pope and Talbot in Spearfish.

We will hear from Janice Crangle of the Black Hills Preschool and Child Care Center in Deadwood, and we thank you very much for being here. And if you could hold the microphone close and summarize your statement for us, and then we will have some questions, and we thank you very much for being here.

STATEMENT OF CHERYL HERBST, DIRECTOR, BLACK HILLS PRESCHOOL AND CHILD CARE CENTER, DEADWOOD, SD, ACCOMPANIED BY JANICE CRANGLE

Ms. HERBST. I am Cheryl Herbst from Black Hills Preschool and Child Care Center in Deadwood. My partner and I began our preschool and child care center 3 years ago. It is a nonprofit organization.

The child care center is licensed for 44 children and the preschool—the preschool services about 60 children. We, in our 3 years of operation, have been dealing with an insurance company that has given us insurance for about $250 a year; and we were notified in October, the end of October, that we had 30 days and we would be discontinued from our insurance.

So in asking why, we were told that we would—that we had turned in medical claims equal to the premiums that we had paid this past year. We did not do that in the 2 previous years, and then that because of nationwide publicity with child care and nationwide concern over availability of insurance in child care and high claims and so forth, that we would not be continued.

So I think part of our problem is the national publicity from the news media with sexual abuse cases, which may or may not have happened, but have been widely publicized; and that our own specific case, then, we have been able to get insurance for this next year but through the same company.

They did decide to reinsure us but told us in 1987 we would have to be insured by someone else. So it looks as though we are dealing with options now, $350 for this coming year—which is reasonable—and then the following year it looks like we may jump to $1,500 for a year, which is going to be very hard for us as a business to absorb.

We are a small business and we are in an area where we are the only licensed day care available. We try to provide a quality program. Our competition is home day cares who are not required to follow the same licensing requirements that we are, and therefore can charge parents smaller fees.

So that governs how high our prices can be to our parents, along with the fact that our parents—children are coming from parents and families who have both parents working and who are finding that if they have to pay a child care center, that it's too high even though they want to provide good quality for their children.

They might as well not work if they have to pay such high prices to a child care center. So we are limited by parents and by staffing regulations and by ratios, insurance costs in the relatively small area that we are living in.

Janice, did you have anything to add to that?

Ms. CRANGLE. I think the biggest issues that we are facing is that we were given such short periods of time in which to deal with our problems. Like Cheryl mentioned before, we were given a 30 day notice, so therefore I proceeded to check out all of our options. There are options available out there; the problem with it is that they are very costly.

We are looking—I am listening to the fees we are talking about and the fees that the cities are talking about, and they are not

comparable at all; but we are also talking about the amounts of money that we bring in and the amount of services that we provide to our community. Like I said, there are options out there. There are things that we can fall back upon. The problem that we faced was not that we couldn't find the insurance, but that we couldn't find the coverage that we wanted.

Until this October, our coverage has been sufficient and luckily we have not had any problems with that, and we haven't had any claims that have been filed to any serious extent against us. But the insurance companies that I spoke to, mostly agents out of Rapid City, suggested that we increase our liability and the amount of coverage that we had. We were previously covered at $300,000 and they suggested that we at least go to $500,000 per incident if there was a claim filed against us, and they also—which we knew, but we had not been able to do prior to this—was that professional liability for myself, Cheryl, and the other director, which is real critical if anything would come back. Because as you mentioned before, Mr. Pressler, they could file against us personally as well as against the organization and we didn't have that coverage.

We needed to get professional liability and we also needed to increase our amount of costs. Our coverage, according to the advice I was given from the other insurance agents and at that point in time—we met with our existing insurance agent, and he came and reviewed our situation and wrote a personal report to his underwriters suggesting and asking that they reconsider us for this next year, in which they did that. But in doing so, they would not give us the additional things on our policy that we asked for. They would not increase our coverage.

Originally he told me he could write professional liability 5 days before we knew—we were up at the end of November. Originally he had told us that we had a 30 day grace period which would have amounted to 60 days from the beginning of when the letter was given to us, and 5 days before that was up we were told we didn't have that grace period.

So we had 5 days to find coverage. He put us in some serious binds. As a result of that, they did decide to rewrite us as existed but they wouldn't add the additional things on that we had asked for. They wouldn't up our coverage and wouldn't give us professional liability, but in doing so they put some exclusions on that were not there prior to that.

So they were putting things on that weren't there, but they weren't allowing us to make some changes with us, so that's a problem. They put a sexual abuse exclusion in there. I don't have much of a problem with that because if that happens within an organization, I figure the person should pay for that; but it would end up affecting us personally, as well as within the organization. So therefore if somebody filed the claim against you, we might personally end up paying for that and that's not OK.

Senator PRESSLER. I imagine it's very difficult to—I imagine it's very difficult to take in children and to be held really responsible for problems that have occurred in other States. I don't think it has in South Dakota. I don't know, but I doubt that there has been, and I visited with child care centers in Aberdeen and Vermillion

and other places and I have never heard of a problem in this State. Yet, you find yourself sort of bearing the burdens of what has happened elsewhere, and let me say that I think you do an excellent job.

What if you hadn't received insurance during that time?

Ms. CRANGLE. There is no way we could continue to operate our organization for 1 day, not even 1 hour. We wouldn't consider running an organization without insurance. If something happened, we personally cannot afford to pay for that. We have to have coverage.

Senator PRESSLER. So you were within 5 days of closing your doors?

Ms. CRANGLE. Yes, it was either that or paying an astronomical amount of money. And as a business, we can't absorb that and—either we absorb that cost personally or it comes out in what we charge our clients. And if we raise our prices, our clients are going to look elsewhere and——

Senator PRESSLER. I think the point you make is that eventually the consumer pays for it, or there are less services. Every business must make a profit to stay in business; and if it can't, it goes out of business and then people want the Government to get involved, and so forth.

So I think you are providing a great service. I commend you, and I think you illustrate not just a business problem; it's also a human problem in that you provide very essential service.

Now, what about getting employees? Do you have to insure each employee individually, or are they all covered within the scope of your employment?

Ms. HERBST. We were given legal advice that our employees would be covered under—we have a personal injury clause in our insurance so that if there is slander or something of this sort from our employees, they are covered for that and they do not need the specific professional liability insurance that we as directors, my partner and I as directors and Janice as our administrator, would need. So we need to be able to provide professional liability for the three of us, not the rest of our staff. We employ 13.

Senator PRESSLER. Now, the huge premium hike that you faced, have you filed any substantial claims which justify an increase in your particular case, or do you think this is just a result of a nationwide situation?

Ms. CRANGLE. The first 2 years we were in business we did not file any injury claims at all, any accident claims at all. And we paid $250—about $250 a year premium.

The third year we filed some accident claims because we figured this was a way to avoid the larger suit—you know, if Johnny fell and bumped his head and needs stitches for $30 at the ER, we felt that by filing a claim with our insurance we could offer that and avoid future lawsuit problems.

Make the family feel that this was an accident, that it was unavoidable. Children do fall. We are staffed well, and that it was covered and the problem—since we did that this past year, we ended up filing claims that were equal to our premium that we paid in, or possibly $20 more, somewhere in there. And so they took that situation and also the national child care center situa-

tion, put the two together and said this looks like a problem; we'd better not insure them again, and that was from our agent's words.

Senator PRESSLER. I think you have illustrated that what is happening in nursing homes, hospitals, wherever services are being carried out, there is so much liability that the services are not being carried out.

I have had truckers come to me and say that they are not able to provide services in certain areas. This is probably a difficult question for you, difficult question for all of us. Do you have any specific legislative proposals—and I wouldn't expect you to have, because you have stated your problem—but as you have listened, do you have any specific legislative proposals you would like to see enacted?

Ms. HERBST. I don't have a specific answer to the problem, but I do think that what I have been hearing about, having individuals who have not had high claims paying for other child cares or other individuals, other situations that have higher claims—for us to pay for their sins just doesn't seem to cut out fair in the long run.

Senator PRESSLER. Well, thank you very much.

I will now call on Mr. Ken Lee of Timberland, manager of Pope & Talbot, Spearfish, where I was the other day, to take the microphone and to give his testimony.

STATEMENT OF KENNETH LEE, MANAGER, POPE & TALBOT, INC., SPEARFISH, SD

Mr. LEE. Thank you for inviting me.

Basically, I am representing about 40 log truck owners that operate in the Spearfish area, and this past year we have had 7 insurance companies cancel insurance with no word at all. Just canceled; no liability insurance, would not handle these people.

We have had a problem this year also with coverage limitation. The companies for the same cost have dropped the limitation down to half with no explanation.

I have talked to numerous agents in the area and they say it's because the log truck is a big risk item, and that they are very much concerned about the accidents that are flashed on the TV and newspaper, where big rigs are in a collision situation.

The lawsuits have mounted over the last few years. As an example, 4 years ago our liability limits were around $300,000. The costs were about $1,500 to $1,800 a year, the same coverage, and it's limited to where you can get this—it's around $3,000 on the lowest level that I can find.

Our company is looking at $1 million liability coverage for our truck drivers. These are owner-operators. We have been turned down by every company that we have contacted. The last two firms that were covering people at $1 million tell us that the end of 1985, which is shortly here now, they will no longer carry the coverage for the people.

We are very concerned about this. We feel we should have the coverage, should have the potential of purchasing coverage at this level. We feel with today's court actions we have to be in the $1 million category, but it looks like we can't buy the insurance.

I talked with two agents day before yesterday and, as you said earlier, it might be that the capitalization that they need is not available so the companies are going to hit us hard for a year or two and then fall back. This does not sound fair to me.

There is a problem that also goes along, that the same two agents told me we would expect 35 to 40 percent increase in liability costs for 1986.

So it's not stopping with this one time shot that we have had this year, but it's going up. Product liabilities, which I am not directly related with, but one of our small sawmill firms is—has a problem with it. He manufactures mine props. He was rudely awakened last Monday with a call from his agent that his coverage was going up 50 percent and they were cutting his coverage by 50 percent.

So he was dropping backward but paying 50 percent more for what he was covering this year. We find this happening all throughout the logging industry. The problem with the logging industry, as you well know, is that we can't pass it on to the consumer. There is no way.

We don't set prices for our lumber. It is a fair market item and prices are set by the marketplace. Our lumber prices are still running close to what it was 4 years ago.

Log truck drivers and loggers themselves are facing a situation that there are no raises available. We are not sure which way we are going to jump.

We know that there is some coverage out there at some level, but it's going to be about twice as high.

[The prepared statement of Mr. Lee follows:]

PREPARED STATEMENT OF KENNETH LEE, MANAGER, POPE & TALBOT, INC., SPEARFISH, SD

I am Kenneth Lee, 1965 graduate with a B.S. in Forest Management, a licensed professional forester employed by Pope & Talbot, Inc., a logging and lumbering firm in Spearfish as their Timberlands Manager.

We employ twelve independent logging contractors, who each have three to twenty workers and subcontract log hauling with other private owner operators of logging trucks. At any one time there may be a total of 40 log trucks delivering logs to our sawmill from the twelve main contractors.

In the past year (1985), seven insurance companies have cancelled liability policies with our truckers.

Four years ago, contractors liability limits were written at $200,000 coverage. The yearly costs were in the neighborhood of $1500-1800. The same coverage now is around $3,000 yearly. In addition, trucks operating on the federal highway system are now required to have $1,000,000 libility coverage. We can not get any insurance company to cover the loggers at this level. The only two firms that have written the $1,000,000 coverage in 1985 will not extend policies any longer.

Pope & Talbot's company policy concerning contractors coverage limits is being debated presently at $300,000 ~~for a~~ To $500,000 maximum. Talking with

the various insurance agents in our area, it now seems likely we may find this range of liability limits for trucks with many limitations and exceptions for $4,000 to $4,500/year.

The contractors and I have been informed by the various insurance agents that trucking is too big of a risk due to liberal court settlements for car, truck collision, or any related big rig accident. Our country, and especially here in South Dakota, depend on the big rigs for our livestock movement, our produce, and other needed manufactured items. This country runs on wheels!

It is interesting to note, however, that some of the agents (unnamed) say that the problem is not only the suits and settlements, but that most of the insurance firms invested large percentages of their income from the policies into other high risk, high interest situations here and overseas several years back and because of the falling interest rates and possibly bad investments are in need of big money and the consumer must pay to bail them out. We did not cause the bad risk, but are now expected to pay or force our government to bail them out!

We can see that there will be fewer insurance companyes and firms willing to cover our loggers with 100 plus percent higher rates in 1986. Without coverage, we can not operate and we do not wish to. But there is no way loggers can pass on the higher cost and no way to absorb them either with lumber prices remaining low as far as we can see.

All of us will be facing the same challenge, be it the local attorney to the zealot politician.

Drastic measures may have to be imposed through federal statues on limitation on settlements.

Personally, I cannot feel good about this action. (There has to be a risk in our system for it to work well). However, for the good of our society and economic structure, we need to control the perspective of a few that have fantasized the worth and damage magnitude of a hurt or loss, and we cannot bail out everyone thats made a management mistake.

One trucker suggested we should stop carrying liability insurance for everyone and by doing so, there would be no guarantee there would be someone getting paid,therefore less suits , thus allowing the courts to get on with what's necessary

Senator PRESSLER. I think you kind of illustrated what is happening in an area of business where a service is provided. What types of lawsuits in general, without being specific—we don't want to, unless you wish to—but what types of recoveries or lawsuits have been experienced in this area or in this part—are you also the victim of a nationwide trend, that are results of local accidents and lawsuits?

Mr. LEE. We feel we are victims of the other States. We are put in a category of cross-country haulers, which we are not. Our logging trucks operate within the Black Hills area, probably put on somewhere around 35,000 to 40,000 miles a year and never leave South Dakota, or maybe the edge of Wyoming. So we feel we are paying for losses that are occurring elsewhere.

Senator PRESSLER. Now, if these costs can't be passed on and can't be absorbed, what does this mean for the logging industry? What, specifically, does it mean for jobs in the Black Hills, and will businesses in your area be forced out of business?

Mr. LEE. This is a tough question. I think people are very ingenuous. They are going to work. The thing that bothers us is they are going to work without insurance.

It's quite simple. If you are forced into a corner to do something that is not legal, that means falsify an insurance certificate, which I can go to the printer's office and buy a bunch of them.

I think the men and women that are working out there want to work. They are going to try to find, somewhere, a limit that they can live with. It may not be adequate, and I guess this is where we get in a situation. We have not had any large lawsuits. We have had some accidents. One that was related to me was where a young gentleman that has been driving for probably 4 years lost his logging truck. He could get insurance coverage now, but it is $25,000 a

year from $3,600. We have been very fortunate to have very good professional drivers and not have had serious accidents or lawsuits.

I believe the people are going to work and we are going to continue to look for the insurance firms that will try to cover us. We are at their mercy at what levels, though.

As an example, one gentleman asked me to relay this to you. He and his wife made 15 phone calls to 15 different insurance companies—not agents, companies—and was refused in every case. A local agent was able to find some coverage for him, and this agent from the southern hills—the best coverage he could get for this gentleman, which has a perfect record, was a $300,000 limit at about four times the cost.

Senator PRESSLER. This morning in driving down here from Terry Peak we passed a couple of these rigs that have logs on — two, one trailing behind the other. Are they probably independent truckers or are they part of your organization? Are they probably independent persons hauling those logs?

Mr. LEE. More than likely it is an independent owner-operator. That is the way we function in this part of the State.

Senator PRESSLER. And what has happened to that guy's insurance rates, probably?

Mr. LEE. His insurance rates have gone up a minimum of 50 percent, and more than likely, 100 percent. The last numbers I have on $500,000 coverage for the one that has never had an incident was $4,500 per year, and that's on a month-by-month basis now, which is very interesting.

Senator PRESSLER. As I understand it, I think your company is basically an Oregon-based corporation. At least, Senator Packwood once—I saw some of their people out there. Are they experiencing the same thing? Is it worse here, or is it the same?

Mr. LEE. It is the same there as it is here. Our company has faced a 600-percent increase in liability coverage on our insurance for our vehicles.

Senator PRESSLER. And last—and you are welcome to complete your answer on this on the record—what specific legislative steps would you like to see either the State or Federal Government take?

Mr. LEE. We have been pondering this. I say, we; I talked to my boss about it. We are concerned about the Government having to get into every corner of our lives. We would feel that the State should get a crack at this.

However, there are some real strong tendencies to say there should be some kind of limitation, and it should be uniform. This gets us into the concept—I think it was Mr. Shultz who said the worker's compensation concept, and maybe that's not all the way it should be.

The American people, we have to live with risk because that's the way our system has survived, but a guaranteed situation causes a problem. Possibly the high liability limits today have caused this.

People see a guaranteed thing there and it seems to me that a lot of us are very willing to settle, very quickly, these claims. This is a little bit different, but worker's compensation in this State has a problem. People are out of their own pocket paying for accidents so they do not have to have their insurance rates go up. This is not what the insurance system was set up to be.

Senator PRESSLER. Well, I thank you very much.

I will now call, in order, Gary Jensen of the South Dakota Bar Association and I also call Bill Honnerkamp, who has arrived forward.

STATEMENT OF GARY D. JENSEN, LAW FIRM OF LYNN, JACKSON, SHULTZ & LEBRUN, P.C., REPRESENTING THE SOUTH DAKOTA STATE BAR ASSOCIATION

Mr. JENSEN. My name is Gary Jensen. I am with Lynn, Jackson, Shultz & Lebrun here in Rapid City, and I am here as a representative of the South Dakota State Bar Association to testify on what's being called the insurance crisis.

The South Dakota Bar Association consists, of course, of all the lawyers in South Dakota. At the present time we have over 1,100 members, to include lawyers from cities and towns, of course, and lawyers who do trial work and those who don't.

Because of the small size of our State, most lawyers who do trial work are going to have a mixed type of practice; that is, in certain cases they will represent the injured party, while in other cases they will represent the people who have been sued and their insurance companies.

So we represent everybody concerned in this type of problem or issue, and so we try to be objective and fair to everybody concerned.

With that background, what we would ask you and Congress, first of all, is to make sure that you find out what the real facts are before anything is done.

As you know, and I think this was probably set out in your newsletter announcing these hearings, this is not the first time we have been told by the insurance industry that there is a crisis in their system and a crisis in the legal system.

You will recall about 10 years ago there was a similar crisis when the insurance companies were then also at the bottom of their cycle, their profit cycle. At that time the Federal Government studied the problem and the Department of Commerce concluded there was no insurance crisis, that the insurance industry had panicked and overreacted to what was a temporary economic climate.

The Department of Commerce also determined that there was very little factual information to base a claim of crisis on. Essentially they said, "You are overreacting."

Currently, we think again there is very little specific information to go on, but what information there is would again suggest that what problems exist, exist by virtue of insurance company practices and investment practices, not problems with the tort system.

As has been mentioned earlier today, insurance companies in the late 1970's and early 1980's—and as you mention in your newsletters—cut their insurance rates and sold their insurance too cheaply to get the premium dollars, turn it around and invest it in the money markets and the like. And they are now having to play catch up.

This cash-flow underwriting, as it is called and as you mentioned in your newsletters, got all of the insurance industry in trouble and we really believe that is the cause of what problems exist.

There was a recent article in the Minneapolis Star and Tribune which we attach to our written statement, by a risk manager from Minneapolis. That risk manager said, among other things:

> In truth, the insurance industry bears much of the blame for its problem. The industry must own up to its deficiencies, admit to the vacuum in leadership, poor management, weak, undertrained and understaffed underwriting and claims-adjusting staffs, underutilization of data processing, inadequate reserving practices and, above all, greed.

Now, I don't know whether you are aware of it or not, but at least three editorial staffs in South Dakota appear to agree with what this fellow was saying in Minneapolis.

The Rapid City Journal recently said that the insurance crisis is not the crisis that some of the insurance agents would have us believe. They said—the Journal did—that it appears that it is something that is temporary and will work itself out, and the State legislature should not have to get involved in private special interest group problems primarily of its own creation.

The Argus Leader and the Yankton daily paper issued similar editorials. We attach copies of those to our written statement and urge you to read those.

We have heard some this morning, and every time the subject is discussed. Of course, you hear it is problems in the legal system that have caused what is being called an insurance crisis. Again, we attach to our statement copies of studies done by people who have studied the tort system, the legal system as we have it and have had it for 200 years.

Those studies conclude that people in this country don't sue any more than in any other country. The severity and frequency of lawsuits is not increased and jury verdicts, especially in States like South Dakota, have not gone wild.

The State bar is against Federal intervention into the legal system. We are against intervention into the insurance crisis, if that is truly what it can be called. We don't believe that Congress should attempt to immunize special interest groups of any sort, whether it be government, doctors, lawyers, engineers, anyone.

We believe that everybody should be treated equally under the law. The fact is, Senator, that somebody is going to have to pay when people are hurt. The system as it is set up now means that those who are responsible for causing the injury or death pay, as opposed to society or taxpayers, which is what will happen if some of the legislation discussed is passed.

Even if you set limits, even if you set a $200,000 limit in a particular case, in these days with medical costs—if nothing else—the way they are, $200,000 limit—well, it may sound like a lot of money, but it may not even cover prior medical expense, let alone what will be incurred in the future.

It doesn't appear as if there is a real insurance crisis, and perhaps the best proof of that is provided by a study conducted by the General Accounting Office of the Federal Government. Again, we attach a copy of that to our written statement.

The General Accounting Office in a report dated just 3 or 4 months ago determined that from 1973 to 1984 property casualty insurance companies sustained $28 billion in underwriting loss, but

generated about $100 billion in development gained or income, for a total gain of $72 billion.

During that same period of time these insurance companies paid $1.3 billion only in Federal income tax, or a rate of 2 percent.

The General Accounting Office has suggested that perhaps the income tax laws be changed so that the companies that are making this incredible profit pay their fair share of tax. We don't have it finalized yet so I couldn't attach it to the written statement, but I do want to point out—and I think Attorney General Mark Meierhenry will be doing it this week in letters to editors across the State—in 1984, insurance companies in South Dakota collected premiums for medical malpractice of $5.5 million. That's in 1984.

In 1984, claims actually paid by those carriers was only $1.255 million. In other words, in 1984 only 23 percent—about 23 percent of every premium dollar collected for medical malpractice—went to claims and defense costs, leaving a profit of about 77 percent plus the investment return on that money.

In other words, malpractice premium generated on an annual basis has been around $4 million, and claims paid between $1 million and $1.5 million, leaving a profit of $2.5 million plus investment income.

So we suggest those figures do not reflect an insurance crisis, or at least an insurance crisis that people are talking about.

Again, we would request that you and your committee and Congress aggressively search out the facts and insist on detailed and accurate and specific and documented information, not argument and innuendo that their verdicts are outlandish.

I can assure you verdicts are not outlandish in South Dakota. South Dakota should not have to pay for the sins of other States. The basic system we are talking about here—and that some in the insurance industry would like to change—is a system of trial by jury, where the jury decides if something was done wrong; and if it was, how much should be paid.

Trial by jury is as fundamental a right as there is in this country, has ever been in this country, and is one of the reasons this setup has served us well for over 200 years.

People like those in this room, juries of our peers are the ones that have decided cases for 200 years. They have done an excellent job. No special interest groups should get special treatment.

The people in this country are smart and fair minded. They are entrusted with many other serious decisions, such as who will be in the U.S. Senate. They certainly should be allowed to continue deciding what is right on a case-by-case basis and being allowed to treat everybody fairly and equally.

So again, we thank you and urge you to check out and see if in fact there is a real crisis and, if so, who caused it.

[The prepared statement of Mr. Jensen follows:]

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STATEMENT OF THE SOUTH DAKOTA STATE BAR ASSOCIATION
TO THE UNITED STATES SENATE SMALL BUSINESS COMMITTEE HEARING
ON THE "INSURANCE CRISIS" HELD AT RAPID CITY,
SOUTH DAKOTA ON MONDAY, DECEMBER 30, 1985
WITH SENATOR LARRY PRESSLER PRESIDING

Gary D. Jensen
Lynn, Jackson, Shultz & Lebrun, P.C.
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Senator Pressler and Staff Members, my name is Gary Jensen. I am a lawyer from Rapid City, South Dakota with the law firm of Lynn, Jackson, Shultz & Lebrun. I am here today as a representative of the South Dakota State Bar Association to testify on what is being called the "Insurance Crisis" and related matters.

The South Dakota State Bar Association membership consists of all of the lawyers in South Dakota and a few from other states. At present, over 1,100 lawyers belong to the Association. Its membership includes lawyers from urban and rural areas. It includes lawyers who do trial work and those who do not. Those who do trial work, of course, represent the injured, people and companies who are sued by the injured, and insurance companies who insure those who have been sued.

Because of the small size of our state, most lawyers in South Dakota have a mixed trial practice. That is, in some cases they represent the injured while in other cases they represent the people or company sued by the injured and their insurance

company. South Dakota lawyers typically have a mixture of the two types of cases in their office at any one time.

This mixed type of trial practice gives South Dakota lawyers a broad prospective by which to study issues such as that which we are here to discuss this morning. South Dakota lawyers see, hear and feel the problems and concerns of those who have been injured. We also see, hear and feel the problems and concerns of those who have been sued and their insurance companies. Because our clients are mixed like this, we try very hard to be fair and objective to all concerned.

With this background in mind, we first urge this committee and whole of Congress to aggressively search out and find out what the real facts are with regard to what is being called the insurance crisis before it does anything. Innuendo, argument and incomplete and undocumented factual presentations should not be the basis for action on anyone's part.

As Senator Pressler stated in his newsletter announcing these hearings, the insurance business, like many other businesses, is cyclical in nature. Approximately ten years ago, the insurance industry was at the bottom of its profit cycle as it is again now. At that time, ten years ago, the insurance industry said it was having an insurance "crisis." It asked government for special treatment. It asked that our basic legal system be changed.

The federal government studied this first insurance crisis. It determined that, in fact, there was no insurance crisis. Specifically, the Department of Commerce determined that

the insurance industry had panicked and overreacted to a temporary economic climate. The Department further determined that the insurance industry had little relevant information upon which to base a claim of crisis and that what problems existed were self-imposed by virtue of insurance industry business practice; insurance industry problems were not the result of inadequacies in our legal system.

It appears as if a considered examination of this, the second alleged "insurance crisis" will lead to the same conclusions. Complete and detailed information has not been provided by the complaining insurance companies to back up their claims. What information exists supports the conclusion that business practices of the insurance industry - not inadequacies in the legal system - have again caused what problems exist for them.

As Senator Pressler noted in his newsletter, the insurance industry in the late 1970's and early 1980's sold insurance cheaply so that they could get the premium dollar and invest it at the then-prevailing high interest rates. Unfortunately, insurance companies sold their insurance too cheaply (in some instances even below cost) because the higher than average return on investment could make up for that initial loss. This "cash flow underwriting" worked in times of high interest rates, but did not work when interest rates return to a lower, more normal level as they have done in the last year or so.

Thus, the alleged insurance crisis was created by overly competitive and fiscally careless insurers who kept premiums low

during times of high investment yield only to be forced to overcompensate with enormous premium increases when interest rates returned to normal. Instead of recognizing and owning up to these business practices, some in the insurance industry have blamed the legal system for their problems. A recent article in the Minneapolis Star and Tribune brought out the truth. We attach the article for your review and quote from parts of it here. The article says:

> Apologists for the insurance industry claim the steps being taken are needed to restore the industry's financial health.
>
> They cite large jury verdicts, problems with our civil-justice system, attorney compensation, deregulated rates, and pollution and occupational disease claims.
>
> In truth, the insurance industry bears much of the blame for its problems.
>
> The industry endorsed a practice known as 'cash-flow' underwriting. This practice was supported in the belief that investment income would be sufficient to offset underwriting losses and produce net operating profits, thereby keeping stockholders happy and adding to policyholders' surplus.
>
> For a while that strategy worked. But now investment income has declined, and the industry is in trouble.
>
> The industry must own up to its deficiencies, admit to the vacuum in leadership, poor management, weak, undertrained and understaffed underwriting and claims-adjusting staffs, underutilization of data processing, inadequate reserving practices and, above all, greed.

Editorial staffs of at least three South Dakota newspapers agree with this insurance industry representative. Recently, the Rapid City Journal noted that problems faced by the

insurance industry did not amount to the 'crisis' claimed and that the State legislature should not burden itself with a private, special interest group problem of its own creation which would otherwise work itself out in the near future. We attach a copy of that editorial for your review.

The Sioux Falls Argus Leader and Yankton Daily Press and Dakotan have also recently issued editorials which support the basic legal system as it has existed for over 200 years, support the proposition that wrongdoers, not taxpayers, should pay the bills when people are injured or killed and, finally, support the proposition that no group (doctors, state employees or others) are entitled to special treatment. Everyone should be equal in the eyes of the law. We attach copies of those editorials for your review.

Some in the insurance industry have tried to blame the legal system and the people of this country for their problems. Those who have studied the subject, however, have concluded that people in this country do not sue substantially more than those in other countries. The frequency and severity of personal injury lawsuits has not substantially increased in recent years. Jury verdicts have not gone wild as some would have us believe. They are especially conservative in small, rural states like South Dakota. We attach to our written statement copies of the studies documenting these conclusions.

The State Bar of South Dakota believes in the legal system that has served this country so well for over 200 years.

Trial by a jury of one's peers is as fundamental a right as there is in this country. Trial by a jury of one's peers is the best system ever designed by anyone anywhere to resolve disputes. That system certainly should not be tampered with because one special interest group or another, regardless of who it is, has a temporary problem especially when that problem is self-imposed.

We are against federal intervention into the basic legal system that has served this country so well for over 200 years. Products liability legislation proposed from time to time is unnecessary and unfair to everyone other than manufacturers of products. Other efforts to immunize special interest groups (whether it be government employees, doctors or others) from liability or limit their liability for injuries or death caused by the wrongful conduct is similarly unnecessary and unfair to everyone except the special interest group with political clout enough to get their special treatment legislation passed. Everyone should be equal in the eyes of the law and before the judges and juries of this country.

When people are hurt, someone must pay their medical bills, lost wages, funeral bills and compensate them for the injury done to their lives and that of their families. We believe that those who cause the injury or death should pay - not society or its taxpayers. Furthermore, only by continuing to make the wrongdoer pay for injuries or death will there remain an incentive for people to go about their business in a safe and reasonable manner. The jury system not only compensates those

who have been injured or vindicates those who are not responsible for the injury or death at issue; it also provides incentive for people to carry out their business in a reasonably safe and prudent manner. They must carry out their business in a reasonably safe and prudent manner or pay for damages caused by their carelessness. It would get to be a very dangerous society if people did not have to pay for harm caused to others by their negligence.

It appears as if there is no real insurance crisis. What problems currently exist in the insurance industry appear to have been self-imposed and not the result of any inadequacies in the basic legal system. They are not as severe as some in the insurance industry would have us believe. Perhaps the best proof of that is found in a study conducted by the federal government itself. As you probably know, the General Accounting Office has conducted an examination of the insurance industry as it relates to federal income tax issues. The General Accounting Office has concluded that the insurance industry continues to make more and more money yet pay less and less in income taxes. From 1973-1984, for example, property/casualty insurance companies sustained 28 billion dollars in underwriting loss, but generated about 100 billion dollars in investment gains or income for a net total gain of 72 billion dollars. They paid only 1.3 billion dollars in federal income tax or a rate of about 2%. The General Accounting Office suggests that the income tax laws be changed so that the insurance industry pays its fair share of tax.

As you also undoubtedly know, the insurance industry is exempt from federal antitrust regulations. This state of affairs is difficult to explain especially in view of the fact that 11% of each American's disposable income is spent on insurance premiums. Perhaps that situation should be re-examined by this or another committee of Congress.

Again, we urge you to aggressively search out and determine what the real facts are before doing anything about the alleged insurance crisis. Do not settle for argument, innuendo and incomplete or undocumented factual presentations. Insist on accurate, specific, detailed and documented information about premiums received, investment income earned and claims actually paid. Insist on complete and accurate information about jury verdicts talked about by insurers. Study the cases where substantial jury verdicts have been rendered to see why a jury of your peers has awarded such a sum of money. Ask the jurors why they did it. As a lawyer who has won some cases and lost others, I can tell you that juries, especially in small rural states like South Dakota, do not give substantial awards unless there are very good, sound reasons for doing so.

What can and should be done about the insurance problem is passage of legislation probably at the state level which would require full, complete, specific, detailed and documented disclosure by the insurance industry of all relevant facts, including premiums paid, investment income earned and claims actually, really paid; not claims simply made. Only by finally getting such information can everyone see whether there really is

an insurance industry problem and, if so, who or what is responsible for it.

The people of this country have been deciding what's right and just on a case-by-case basis for over 200 years. The people of this country are smart and fair-minded. They are entrusted with many other important decisions such as deciding who should be in the U.S. Senate. They, the people of this country, not government, politicians or bureaucrats, should continue resolving legal disputes in the future on a case-by-case basis after listening to the facts of that case and working from the basic premise that everyone is to be treated fairly and equally under the law.

Thank you.

Minneapolis Star and Tribune
Saturday, October 19, 1985

Insurance industry bears blame for its own problems

The recent spate of exorbitant rate and premium increases, midterm cancellations, coverage restrictions and lack of needed insurance limits has caused state regulators across the country to begin seriously looking into the problem the situation creates for consumers. They are exploring available regulatory alternatives that might control this knee-jerk, reactionary insanity.

Apologists for the insurance industry claim the steps being taken are needed to restore the industry's financial health.

They cite large jury verdicts, problems with our civil-justice system, attorney compensation, deregulated rates, and pollution and occupational disease claims.

In truth, the insurance industry bears much of the blame for its problems.

The industry and its lobbyists welcomed rate deregulation in the 1970s. No longer would underwriters have to endure the lengthy rate-approval process. New rates could be filed and used. Deregulated rates would contribute to every underwriter's ability to increase written premiums and "market share."

Increasing market share meant reducing rates anywhere from 10 percent to 50 percent during a period when inflation averaged more than 15 percent annually. Consumers were not the driving force behind the rate cuts. The industry encouraged them to seek competitive quotations.

Consumers shopped their insurance and found they were often able to obtain higher limits and superior coverage at little or no additional premium.

For underwriters, the incentive to increase market share was investment income.

The industry endorsed a practice known as "cash-flow" underwriting. This practice was supported in the belief that investment income would be sufficient to offset underwriting losses and produce net operating profits, thereby keeping stockholders happy and adding to policyholders' surplus.

For a while that strategy worked. But now investment income has declined, and the industry is in trouble.

The problem will not be resolved by merely raising rates, canceling policies, excluding difficult exposures to loss or adopting the "claims made" liability policy.

The industry must own up to its deficiencies, admit to the vacuum in leadership, poor management, weak, undertrained and understaffed underwriting and claims-adjusting staffs, underutilization of data processing, inadequate reserving practices and, above all, greed.

While I agree with Commerce Commissioner Mike Hatch that something needs to be done to protect the insurance consumer from such wild and chaotic swings, by the time the Legislature gets around to giving the regulators authority to respond, the industry will have restored its profitability, at least for the short run.

But I hope in the interim that apologists for the industry will admit to the consumer the real reasons for the industry's problems.

Only then can consumer confidence be restored, and just maybe we will all benefit as insurance companies return to their primary purpose: risk-taking.

Michael J. Glapion, Eden Prairie. Risk manager.

David C. Sharp,
President and Publisher

James M. Kuehn,
Vice President and Editor

Jack Cannon,
Editorial Page Editor

Opinion

Legislature will referee liability insurance battle

What shapes up to be one of the hottest topics in the 1986 session of the state Legislature is the cost and availability of liability insurance.

Units of local government as well as private businesses and individuals are having difficulty obtaining liability insurance and those that can are finding that premiums are skyrocketing.

The battle shapes up as one between the insurance industry and the legal profession with the Legislature as referee.

Insurance companies say it has been necessary to increase premiums to cover losses which, industry wide, amounted to $20 billion in 1984. The industry places a large part of the blame for those losses on the size of judgments awarded in liability lawsuits. To stem the hemmorhage, they would like to see legislation putting limits on liability suits.

The legal profession resists such limits. It maintains persons who are damaged by the actions of others are entitled to be compensated. The amount of that compensation should be set according to the individual case and circumstances rather than having an arbitrary limit set by law.

While the size of judgments is partly responsible for the losses sustained by insurance companies, it isn't the only culprit. High interest rates which could be earned on investments during the early 1980s caused companies to cut rates to develop more premium dollars to invest at high money market rates. When interest rates dropped, the companies were caught having to pay claims on business that was written at what amounted to below-cost premiums.

The large premium increases appear to be an over-reaction to claims losses which, while significant, could be covered with much smaller premium increases than those which are being levied.

Because the balance between premium income and claims outgo will take care of itself in time, it would seem the Legislature is not the best place to address the current problem. But it appears inevitable that lawmakers will get caught between the competing interests and be forced to spend an inordinate amount of time that might be spent more profitably on other facts of the public's business.

168

Argus Leader

Sioux Falls, South Dakota

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Victims being ignored in insurance squabble

Editorial

Attorney General Mark Meierhenry was joking, but his solution to the state's insurance problem is about the most practical answer South Dakotans have heard from the hallowed halls of the state Capitol: Paint state vehicles orange with black stripes to warn other drivers to get out of the way.

To that, Gov. William Janklow may want to add a sign on vehicle doors: "Caution. Uninsured state employee."

That's not much of answer, but Meierhenry is right about one thing: South Dakotans — those who don't work for state government — are the real losers since state government lost its liability insurance.

South Dakota government lost its liability insurance Dec. 1, two years into a three-year contract with Colonial Penn Insurance Co., leaving state workers worried that they may be held responsible for job-related mishaps.

No need for worry, Tony Merry, Janklow's chief of staff, says. The state carried insurance not so much to protect itself but to give citizens someone to sue.

"The state has always been protected by sovereign immunity," Merry says. "It's an old concept that goes back to the English legal system. The Constitution and courts have consistently held that we have been immune from suits," Merry says.

In other words, the king can do no wrong.

That may be fine and dandy for the state government and its employees, assuming the archaic immunity concept continues to withstand legal challenges. But immunity also could leave private citizens holding the bag of bills.

Janklow says the cost of retaining insurance at higher premiums would make taxpayers the losers.

"We can't get a quote," Janklow says. "Nobody will sell us a policy. There are seven states in the country in the same boat we are. Government is getting hit with tons of junk lawsuits. It's too expensive."

Janklow says he doesn't know if sovereign immunity is the answer.

It isn't.

Under sovereign immunity, as Meierhenry notes, someone injured in an accident with a negligent state employee couldn't sue the worker or the state. Citizens become victims without rights.

"What has happened, from my observation, is that everyone is treating this as an insurance problem," Meierhenry says. "It is not. It is a problem of how does government compensate the victims of our mistakes."

He says the state could follow the federal government's example and set up a procedure to pay citizens for damages.

If commercial insurance isn't the answer, Janklow and other state officials should explore other ways to compensate victims. Maybe the state will have to insure itself. It might have to set aside enough money to pay legitimate claims.

That's a better alternative than limiting citizens' rights by expanding immunity.

Frivolous lawsuits won't bankrupt the state. Lawsuits that are, indeed, frivolous would be thrown out of court with no damages awarded.

Immunity can only encourage government irresponsibility and turn unfortunate victims into ignored victims.

"I'M SORRY, SIR. BUT SINCE YOU WERE RUN OVER BY A STATE-OWNED VEHICLE I'M AFRAID YOU'RE GONNA HAVE TO WALK TO THE HOSPITAL!"
THAT SHOULD PUT HIM IN HIS PROPER PLACE!
RICH BARNES

Opinion cartoon courtesy of Rich Barnes.

Opinion

10A Wednesday, October 2, 1985

Argus Leader
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Doctors not entitled to special protection

Editorial

Doctors, like the rest of us, make mistakes.

Some mistakes are serious; some aren't. Some create serious problems; some don't.

Increasingly, doctors are being sued for their mistakes. Of course, sometimes their "mistakes" are exaggerated or false claims by unhappy patients who are looking for a fat payday in court.

The threat of being sued is a risk all Americans in all professions face. It's a risk that doctors, in particular, are up against now.

The problem for doctors is not as great in South Dakota as elsewhere. But, nationally, more doctors face lawsuits than ever before. The cost of malpractice insurance and jury verdicts are driving some doctors out of business and worrying others.

The surge in legal attacks has prompted South Dakota doctors to go looking for help they are not entitled to.

The Council of the South Dakota State Medical Association plans to ask the 1986 Legislature for law changes to lower insurance payments. The council wants a $500,000 cap on malpractice awards and other financial and legal protections that no one else enjoys.

That's not right. The request should be rejected.

Putting limits on malpractice awards wrongly limits victims' rights. Doctors should not be entitled to special legal and financial protection.

Safeguards already exist in South Dakota to shield doctors from excessive jury awards and faulty verdicts. Judges have the power to set aside or reduce jury awards and reverse verdicts.

That's protection enough.

We live in a litigious society. Until we change our legal ways, no one deserves a special exception. Including doctors.

Insurance void dangerous; action needed immediately

It's Christmas Eve and a Yankton family — John, Mary and their two small children — are heading for Beresford to spend a few days with grandma and grandpa.

Suddenly, an oncoming car swerves across the center line near Vermillion and plows into John and Mary's car, killing the parents and seriously injuring the children.

Who is going to pick up the medical costs, and the other damage expenses that the family clearly is entitled to? Not the driver of the oncoming car. He was a a state employee driving a University of South Dakota vehicle, and he has no insurance coverage. And, because the state has sovereign immunity, neither South Dakota nor the driver can be sued for damages.

John and Mary's children won't be covered by their own insurance company, either, because the uninsured or underinsured motorists clauses in their policy only pertains to other motorists who are liable, the state attorney general's office says.

It is an incomprehensible situation and one which cannot be allowed. At this moment, how many accidents have occurred involving state employees in which the other party has no right of recovery? The state employee, however, would be covered through his personal or state insurance policy.

In light of all this, South Dakota Attorney General Mark Meierhenry's request for an investigation into the cancellation of the state's liability insurance has come none too soon.

What Meierhenry and others want to know is why Colonial Penn Insurance was able to cancel its policy with the state before the expiration date. The state's Division of Insurance is to investigate the matter. The other obvious question is why the state was so slow in reacting to it. The attorney general's office claims that the insurance was cancelled Dec. 1 and that the state was warned of the cancellation 30 to 60 days previous to that time.

Gov. William Janklow earlier was quoted as saying that the state can't buy insurance because no company will even give it a quote on premium rates. But, he also was quoted as saying that insurance might be available at $2 million a year, compared with $325,000 it was paying at the time of cancellation. There was an update on that Wednesday when Colonial Penn said that it may reinstate the coverage, but at a higher cost. No estimate was given.

Were Colonial Penn's rates too low? Is that why they cancelled, or were there other reasons? Is the company's proposed new rate too high? The state's insurance division, which monitors and approves premium rates for insurance companies doing business in South Dakota, should be able to answer these questions.

Many factors affect insurance rates, including the number and size of claims by the insured and the insurer's profit goals. But to leave innocent accident victims without recourse because the state has sovereign immunity is not the answer.

The best advice to follow now is to avoid any area where state vehicles are in use.

UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

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BY

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BEFORE THE

AMERICAN RISK AND INSURANCE ASSOCIATION

VANCOUVER, B.C.

August 20, 1985

I am pleased to present our views on taxation of the property/casualty insurance industry. We, at the General Accounting Office, have had an active interest in this area for the past 6 years. In 1981 we submitted a report to the Congress on taxation of life insurance companies. Earlier in 1985 we issued to the Senate Finance Committee a report on taxation of the property/casualty insurance industry. Today, I will focus on the latter.

Mr. Chairman, we believe that the Congress should reexamine several aspects of the tax code dealing with property/casualty insurance companies. These aspects include the deduction for loss reserves, the deduction for acquisition expenses, and the protection against loss account. Before explaining why we believe certain parts of the tax code should be reexamined, I would like to provide some background information on property and casualty insurance company pricing strategies, a financial overview of the industry, and the impact on the industry of certain current tax provisions.

PROPERTY/CASUALTY COMPANY PRICING STRATEGIES

A property/casualty company derives its income from underwriting gains (the excess of premiums over claims and expenses) and investment gains. Because of investment gains, a property/casualty company can still have net income even though its premiums alone are not large enough to cover claims and expenses.

Thus, even though a company has a ratio of claims and expenses to premiums in excess of 100 percent, which normally would indicate the company had suffered an operating loss, it may well have a positive net income.

The ability to offset underwriting and investment income has played an important role in a company's pricing strategy--that is, the amount of premiums it charges for the lines of insurance that it offers. For a number of years the companies have been willing to charge lower premiums to compete for certain insurance lines, even though they will have ratios of claims and expenses to premiums in excess of 100 percent. (For example, in some major lines of business, such as medical malpractice and other liability, these ratios have been more than 150 percent.) The companies expect to make up the premium shortfall through investment income. Through the incremental volume of premiums resulting from this pricing approach, companies are able to generate a larger amount of net cash flow which they can then invest to earn additional investment income. For instance, in 1983 when the industry had a combined ratio of claims and expenses to premiums of about 112%, which produced an underwriting loss of about $11 billion dollars, it still had a net gain of about $9 billion and generated a total of about $12.1 billion in net cash flow, as reported by Best's Management Reports.

While in past years investment gains have exceeded underwriting losses by a fairly wide margin, in more recent years the gap has narrowed. For example, in 1984, underwriting losses for

the industry were $20.5 billion, while investment income and realized capital gains were $20.8 billion. As the margin has narrowed, many companies have reacted by raising premiums. Given this, it does not seem unreasonable to expect the gap to widen again as companies within the industry implement new pricing strategies.

FINANCIAL OVERVIEW OF THE PROPERTY/CASUALTY INDUSTRY

We developed a financial overview of the property/casualty insurance industry by studying financial data for stock and mutual companies for the 10-year period 1974 through 1983. We obtained these data from Best's Aggregates and Averages. While Bests' reports omit figures for many small and/or new companies, we believe that the data are sufficiently representative of the overall financial results of the property/casualty industry.

In tables 1 through 5 we show sources of income, broken out by underwriting gains, investment gains, and total gains. We also show disposition of income, broken out by the increase in surplus, dividends to stockholders, and the combined total. Federal income taxes are also shown.

We show in table 1 that, while property/casualty companies had about $28 billion in underwriting losses from 1974 through 1983, they had about $100 billion in investment gains during this period, resulting in a total gain of about $72 billion for those years. From 1974 through 1983, property/casualty companies paid $1.3 billion in federal income taxes, an amount equal to about 2 percent of the industry's total gains for the period.

Table 1

All P/C Companies - Consolidated Basis
1974 through 1983
(in billions of dollars)

Underwriting gains	Investment gains	Total gains	Federal income tax	Percentage of federal income tax to total gains
($28.4)[a]	$100.7[b]	$72.3[c]	$1.3[d]	1.8

[a]Positive gains in 1977 78, 79, negative in other years.
[b]Negative gain in 1974; positive in other years.
[c]Negative total in 1974; positive in other years.
[d]Negative taxes in 1974-75; 1982-83; positive in other years.

Table 2 shows that about $44 billion of property/casualty companies' income from 1974 through 1983 went to an increase in surplus, and about $17 billion to stockholders in the form of dividends. These two items totaled about $61 billion, and the $1.3 billion paid in federal income tax during this time equal 2 percent of this total.

Table 2

All P/C Companies - Consolidated Basis
1974 through 1983
(in billions of dollars)

Increase in surplus	Dividends to stockholders	Total	Federal income tax	Percentage of federal income tax to total
$44.3[a]	$17.0	$61.3[a]	$1.3	2.1

[a]Negative in 1974; positive in other years.

The figures in tables 1 and 2 refer to mutual and stock companies combined. Since only stock companies give dividends to stockholders, we developed table 3 to show some ratios solely for stock companies.

We show in table 3 that from 1974 through 1983, stock companies had total gains of $59 billion and, as we previously mentioned, distributed about $17 billion to stockholders as dividends. During this period, stock companies paid $200 million in federal income taxes, an amount equal to 0.3% of their total gains and to 1.2% of their dividends paid.

Table 3

Stock Companies
1974 through 1983
(in billions of dollars)

Total gains	Dividends to stockholders	Federal income tax	Percentage of federal income tax to total gains	Percentage of federal income tax to dividends to stockholders
$59.0	$17.0	$0.2	0.3	1.2

We also wanted to see how the 20 largest companies compared with the other companies. Tables 4 and 5 provide results separately for stock and mutual companies.

Table 4

Stock Companies
1974 through 1983
(in billions of dollars)

	Total gains	Federal income tax	Percentage of federal income tax to total gains
20 largest companies	$19.8	($1.0)	(5.1)
All other companies	39.2	1.2	3.1
All companies	59.0	0.2	0.3

Table 5

Mutual Companies
1974 through 1983
(in billions of dollars)

	Total gains	Federal income tax	Percentage of federal income tax to total gains
20 largest companies	$17.2	$0.9	5.2
All other companies	5.6	0.4	7.1
All companies	22.8	1.3	5.7

Tables 1 through 5 have shown that from 1974 through 1983 the industry as a whole, in spite of its underwriting losses, had positive net gains yet paid a small percentage of these gains, 1.8 percent, in federal income taxes. For stock companies, the percentages of taxes paid were lower than for mutual companies--0.3 percent for stock companies and 5.7 percent for mutual companies.

For large companies, the percentages of federal income taxes paid were lower than for smaller companies. For stocks, the 20 largest companies had an income tax rate of -5.1 percent as compared with 3.1 percent for the smaller companies. For mutuals, the 20 largest companies paid 5.2 percent as compared with 7.1 percent for the smaller companies.

As previously mentioned, tables 1 through 5 each cover the 10-year period ending in 1983. Information is not yet available for updating all of the tables through 1984. However, preliminary information shows that the property/casualty companies had a record underwriting loss in 1984 and, as we indicated, investment gains (including capital gains) were approximately equal to the underwriting losses.

Using data from our table 1 and from the preliminary information that has been published for 1984, we constructed table 6 to cover the 10-year period 1975 through 1984.

Table 6

All P/C Companies - Consolidated Basis
1975 through 1984
(in billions of dollars)

Underwriting gains	Investment gains	Total gains	Federal income tax	Percentage of federal income tax to total gains
($47.0)	$119.1	$72.1	($0.063)	(0.1%)

These figures show that from 1975 through 1984 the investment gains exceeded the underwriting losses by over $72 billion while taxes were a negative $63 million, a rate of -0.1% of the total gains.

IMPACT OF CURRENT TAX PROVISIONS

Our analysis of the foregoing financial data gives insight into how current tax policy affects the property/casualty insurance industry. As a result of certain tax advantages, many property/casualty companies have not paid federal income taxes for a number of years, and, in fact, have qualified for refunds or the ability to carry back or carry forward losses for tax purposes. In addition to the tax deferrals resulting from the treatment of loss reserves, the treatment of acquisition expenses, and the protection against loss account, property/casualty companies can also use tax provisions available to other taxpayers. These include excluding interest income from tax-exempt securities and deducting eighty-five percent of the dividends received from domestic corporations. Between 1975 and 1982, about 40 percent of the gross investment income of all property/casualty companies was tax-exempt investment income. The dividends received deduction during this period represented about 20 percent of the gross income of the companies.

While we presented and discussed these facts in our report, we did not recommend any changes in the application of the exclusion of tax exempt interest or the dividend received deduction to property/casualty companies. We limited our study to those provisions of the tax code which applied only to property/casualty companies.

AREAS OF PROPERTY/CASUALTY INSURANCE TAXATION NEEDING CONGRESSIONAL REEXAMINATION

We indicated in our report on the taxation of the property/casualty insurance industry that the Congress should reexamine three areas of the tax code.

These areas are

--the deduction currently allowed for loss reserves;

--the practice of currently deducting all of the expenses associated with the sale and renewal of insurance policies; and

--the protection against loss account, which defers a portion of a mutual company's income to provide a cushion for catastrophic loss.

Our conclusions and recommendations in each of the three areas were as follows:

First, we concluded that the present practice of deducting in the tax year the full (undiscounted) amount of future estimated settlement costs overstates the loss reserve deduction. Since the assets underlying loss reserves are invested pending final settlement of claims, the firm actually needs to set aside only that amount which, together with subsequent investment earnings, would equal expected subsequent claims. We suggested that the Congress consider amending the tax code to provide that for tax purposes loss reserves be discounted in calculating the loss reserve deduction. We further stated that the discount rate should be based on a moving average of each company's pre-tax net return on its investment portfolio.

We estimated discounted loss reserve levels at several discount rates for 1980-82 (holding all other factors constant) and the additional tax liability that would have resulted. The higher the discount rate used, the greater the reduction in the loss reserve deduction and the greater the increase in tax liability. If a hypothetical discount rate of 7 percent had been used by all companies in 1982, the deduction taken would have been reduced by about $1.3 billion, and tax liabilities would have been greater by about $613 million.

Second, we concluded that the present treatment of acquisition expenses fails to match expenses and revenues. Currently, the tax code permits all acquisition expenses to be deducted immediately, even though the premiums associated with these expenses are spread over the life of the contract. In this case we suggested that the Congress consider amending the tax code to provide that acquisition costs be allocated over the life of related contracts so that these costs are matched with premium payments generated by the contracts.

If acquisition expenses were allocated when revenue is recognized, then taxable income would increase. We estimated the additional tax liability that would have accrued for the years 1980-82 if this change had been made and everything else had remained the same. Based on these assumptions, the additional tax liabilities would have been approximately $164 million in 1982.

We must mention that for both the changes in the tax code the Treasury in 1982 would have received only a portion of these amounts in additional current taxes. Some companies were showing losses for tax purposes. Furthermore, companies might shelter more of their investment income and thereby mitigate any increases in taxes. This could be done through increasing their holdings of tax-exempt securities or equity securities of domestic corporations.

Third, we concluded that the protection against loss account may not protect mutual companies against catastrophic losses because the money in the account is not earmarked for that purpose. Thus, if a catastrophic loss were to occur, the account does not necessarily ensure the company's ability to satisfy its contract obligations. In this case, we recommended that the Congress consider whether or not this special tax preference for mutual property/casualty insurance companies should be retained in its present form.

CONCLUSION

In conclusion, Mr. Chairman, the financial information we have presented indicates that the property/casualty insurance industry has paid a relatively small share of its net income in federal income taxes in recent years. While we are not in a position to comment on what might be an appropriate federal tax burden for the industry, we do believe that the Congress should consider amending the tax code along the lines suggested in our report. In our view, the changes would result in a better match of the industry's revenues and expenses and represent a more rational approach to its taxation.

This concludes my prepared remarks.

RESPONSE TO QUESTIONNAIRE OF THE U.S. GENERAL ACCOUNTING OFFICE REGARDING MEDICAL MALPRACTICE

Public Affairs Department

Association of Trial Lawyers of America

MALPRACTICE CLAIM FREQUENCY AND SEVERITY

A frequently heard explanation of the "crises" of availability and cost in the mid-1970's and the mid-1980's has been based upon a supposed increase in both claim frequency and claim severity. In fact, there has been no substantial increase in either frequency or severity of malpractice claims.

1. Malpractice Claim Frequency

Vital to the claims of the medical-insurance complex is this myth that we live in a "litigious society." This part of the argument holds both that we, as a people, are more likely to sue than other people, and that we are more likely to sue than we used to be. Neither turns out to be true.

A recent survey of the litigiousness of citizens of major industrial nations clearly showed that Americans are really quite normal in terms of their tendency to sue:

> "[T]he United States rate of per capita use of the regular civil courts in 1975 was just below 44 per thousand. This is in the same range as England, Ontario, Australia, Denmark, New Zealand, somewhat higher than Germany or Sweden, and far higher than Japan, Spain or Italy. ... According to a recent report, some five million cases are filed in Yugoslavia each year, an astonishing figure for a country of 22 million persons." (1)

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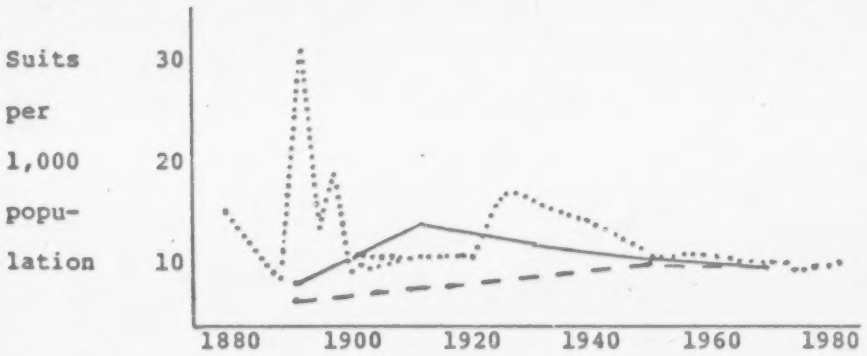
(1) Galanter, Marc, "Reading the Landscape of Disputes: What We Know and Don't Know (and Think We

If we are not particularly likely to sue when compared with our industrial brethren, are we more likely to sue than we use to be? Again, the answer is a clear no. As the following graph indicates, there is no clear trend toward an increase in the tendency of Americans to bring a civil lawsuit.



Los Angeles County, CA =·····
Alameda County, CA =————
San Benito County, CA =— — — —

Sources: Galanter, supra at fn (1), p.40; Selvin, M. and Ebener, P., Managing the Unmanageable: A History of Civil Delay in the Los Angeles Superior Court, The Institute for Civil Justice, Rand Corporation (1984), p.34.

As Professor Galanter explains, then, "the pattern of use [of the law to resolve disputes] is conservative, departing relatively little from earlier patterns." (2)

These findings are echoed in a recent report by Stephen Daniels of the American Bar Association:

> "Generally speaking, ... there is no single, consistent overall trend shared by all the courts ..., and there does not appear to have been any golden age of low caseload rates." (3)

What, then, of such facts that nearly twice as many civil actions were filed in federal district courts in 1983 as in 1977? (4) Doesn't that prove we

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Know) About Our Allegedly Contentious and Litigious Society," 31 U.C.L.A. L.Rev. 4, 55-56 (October, 1983).
(2) Galanter, supra at fn (1), at 70.
(3) Daniels, Stephen, "We're Not a Litigious Society," The Judges' Journal (Spring 1985) 18, 47.
(4) "Federal Judicial Workload Statistics During the

are more likely to sue than we used to be? No, as Professor Galanter explains:

> "[O]ne third of the whole increase consisted of a jump from 600 to 41,000 cases filed by the federal government to reclaim overpayment of veterans' or Social Security benefits or to collect on student loans. The next largest gain was an increase from 3,000 to 20,000 in claims to restore disability payments cut off by the Reagan Administration. ... These numbers reflect specific social and political events and don't point to any across-the-board increase or decrease in litigiousness." (5)

This lack of increase in claim frequency is likewise true with respect to medical malpractice claims. While data in this area is quite incomplete, we do know that in 1975, 23,240 medical malpractice claims were filed, or about 6.4 per 100 physicians. (6) In 1983, approximately 42,000 claims were filed, or about 8.1 per 100 physicians. (7) In other words, at worst, the increase in frequency over the last decade has been at an annual rate of about 3.4%. This rate of growth is entirely explained by several sociological and demographic changes in our society: the over 25% increase in physician density (8), the sharp increase in number of potentially injury-producing patient contacts (9),

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Twelve Month Period Period Ended December 31, 1983," Administrative Office of the United States Courts, (1984).

(5) "Americans' 'Litigation Binge' Is a Myth," U.S. News & World Report (November 1984).

(6) Danzon, P.M., "The Frequency and Severity of Medical Malpractice Claims", The Institute For Civil Justice, Rand Corporation, p.6 (1982); Statistical Abstract of the United States 1984, 104th Edition, U.S. Department of Commerce, Bureau of the Census, pp.6, 109 [hereafter referred to as "Statistical Abstract"].

(7) AMA Report I, p.10; Statistical Abstract, pp. 6, 109.

(8) Statistical Abstract, pp.6, 109; People's Medical Society (February 1985), p. 7. Dr. Danzon has estimated that [a]n increase of 100 doctors per 100,000 population is associated with an increase of 3.6 claims per 100,000 population." "Frequency and Severity...", supra at fn (5), p. v.

(9) There was a 62 percent increase in the number of surgical operations in short-stay hospitals from 1971 to 1981. Statistical Abstract, p. 117.

and the increasing complexity and intensity of medical care, to mention but a few. A recent study of the Pennsylvania medical malpractice situation sponsored by, among others, the Hospital Association of Pennsylvania, the Pennsylvania Bar Association, the Pennsylvania Defense Institute, the Pennsylvania Medical Society and the Pennsylvania Trial Lawyers Association, agreed that there was "no verifiable increase in actual malpractice occurrence." (10)

As was recently concluded by the Florida Governor's Task Force on Medical Malpractice:

> "The increase in malpractice actions can be attributed to a variety of factors. With health insurance and government funding, more people have access to medical care. Technological advances have increased the risks of iatrogenic injury. Care is being rendered in a variety of locations and the number of providers has not only increased, but care by specialty has increased. There are significantly more variables, more actors, more settings, more procedures, and more risks." (11)

Once all these factors are considered, it becomes clear that there has been no statistically significant increase in claim frequency.

One point must be made regarding the tendency of newly-formed doctor-owned insurance companies, such as New York's Medical Liability Mutual Insurance Company (MLMIC) to claim startling increases in claim frequency: such claims completely ignore the fact that the first decade of any new malpractice company, underwriting association, or catastrophic injury fund is marked by "pseudo-growth" characteristic of all new insurers. A highly simplistic example will demonstrate this growth. Assume a medical malpractice insurance company is formed in 1979 and that, for the next several years, the company's insureds incur 100 claims for each policy year, i.e., the company experiences no growth in claim frequency per policy year. Assume also

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(10) Hofflander, Alfred E., Ph.D. and Nye, Blaine F., Ph.D., "Medical Malpractice Insurance in Pennsylvania," Management Analysis Center, Inc. p.26 (1985).

(11) "Toward Prevention and Early Resolution, Report and Recommendations of the [Florida] Governor's Task Force on Medical Malpractice," (April 1985) p. 34.

that claims are filed against this company at the rate found to be typical of the industry in the 1978 HEW/Industry Study. (12) The following table demonstrates how a zero-growth claims frequency can produce an apparently startling rate of growth. (13)

HYPOTHETICAL CLAIM FREQUENCY DEVELOPMENT

	YEAR CLAIM FILED									
POLICY YEAR	1979	80	81	82	83	84	85	86	87	88
1979	56	25	11	3	2	1	1	1		
1980		56	25	11	3	2	1	1	1	
1981			56	25	11	3	2	1	1	1
1982				56	25	11	3	2	1	1
1983					56	25	11	3	2	1
1984						56	25	11	3	2
1985							56	25	11	3
1986								56	25	11
1987									56	25
1988										56
TOTAL	56	81	92	95	97	98	99	100	100	100
% INCR. SINCE 1979	-	45	64	70	73	75	77	79	79	79

Using MLMIC's "analysis", one could claim that our hypothetical company, while in fact experiencing absolutely no true growth in claims frequency whatsoever, suffered a "73 percent increase in claims frequency from 1979 through 1983." While this exercise is in no way intended to serve as an actuarial model for

(12) According to that study, 56% of malpractice claims are filed within the first year, 25% in the second, 11% in the third, 5% in the fourth and fifth years, and 3% after the fifth year. "Medical Malpractice Claims - Synopsis of the HEW/Industry Study of the Medical Malpractice Insurance Claims," Public Health Service and Health Care Financing Administration (October 20, 1978), Table 7-7.

(13) For the purposes of this example, the 5% filed in years four and five will be split between the two years (3% in year four, 2 % in year 5), and the 3% of claims filed after the fifth year will be presumed to have been filed 1% at a time over the sixth, seventh, and eighth years, even though, in reality, those claims would be filed over a number of years after the eighth year.

comparison of physician-owned companies, it does reveal why, under MLMIC's analysis, physician-owned companies have apparently experienced a substantially higher growth in claims frequency than have the older corporate insurers.

Finally, no discussion of increases in frequency of malpractice claims can fairly overlook one important issue to be discussed more completely later: virtually every study which has examined the question of the incidence of actual malpractice has shown that there is at least ten times as much actual malpractice as there are claims for malpractice, and fewer than half of those claims are paid. In other words, fewer than one in twenty-five instances of malpractice are compensated by the "system". (14) How, then, can this "system" be criticized as being overly generous in its compensation of the victims of medical carelessness? The truth is, it cannot.

2. Malpractice Claim Severity

The twin horsemen of any insurance "crisis" are increased frequency and severity of claims. As we have seen, there is certainly no crisis of frequency. Is there, then, a crisis of severity? Are American juries handing out unjustifiably large awards which are not merited by the facts? Again, the answer is no.

The critical question at this juncture is: by what standard are we to measure increases in severity? Given inflationary pressures, what could we have expected to have happened to the size of the average claim? While the standard consumer price index (CPI) is one possible standard, it does not reflect the fact that the great bulk of medical malpractice verdicts and settlements are based upon medical expenses. (15) It would therefore seem more appropriate, as a general principle, to use the Medical Cost Index (MCI) or national health care expenditures (HCE) when examining trends in medical malpractice claims, settlements, verdicts, and insurance.

(14) Danzon, P.M., "An Economic Analysis of the Medical Malpractice System," 1 Behavioral Sciences & The Law 39, 40 (1983)

(15) Economic Report of the President, 1984 Edition; "Congress Should Consider Changing Federal Income Taxation Of The Property/Casualty Insurance Industry," U.S. General Accounting Office, GAO/GGD-85-10 (March 25, 1985), p. 6.

The 38% rise in claim severity for the years 1981-1984 recently reported by St. Paul is, in fact, a growth rate of only 8.4% per year, well under the annual 10.5% growth in MCI and the 13.3% growth in HCE for that period of time.

At first glance, the more extreme growth figures for the doctor-owned companies seem much harder to understand. However an important and often-overlooked fact about doctor-owned companies is that, as new companies with less than a decade of experience, these companies generally have only recently started to encounter the larger, slower-developing claims, such as the brain-damaged infant cases. In other words, malpractice claims paid soon after the precipitating incident are the less expensive claims - the less serious injuries. The NAIC Closed Claims Study of 1975-1978 revealed that the average value of claims settled more than four years after the incident was over 13 times as great as that of claims settled in the first six months, and over 4-1/2 times as great as that of claims settled in the first two years. (16)

The combination of inflation (both MCI and HCE) and this form of "pseudo-growth" which produces apparently severe growth rates in the average claim of newly-formed companies can be illustrated in a hypothetical involving a company which began operations in 1979. In this hypothetical, the company incurred 100 claims in each policy year. The values for average claims are taken from the HEW/Industry Study.

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(16) "Medical Malpractice Claims: Synopsis of the HEW/Industry Study of the Medical Malpractice Insurance Claims," Health Care Financing Administration, U.S. Department of Health Education and Welfare, HCFA-02108 (1979), Table 7-8.

HYPOTHETICAL CLAIM SEVERITY DEVELOPMENT

(The top figure of each pair of figures reflects the value of the average claim; the bottom reflects the number of claims.)

POLICY YEAR	YEAR CLAIM FILED 1979	1980	1981	1982	1983
1979	5215	16039	26940	36799	49040
	19	21	22	24	5 (17)
1980		5215	16039	26940	36799
		19	21	22	24
1981			5215	16039	26940
			19	21	22
1982				5215	16039
				19	21
1983					5215
					19
TOTALS					
CLAIMS:	19	40	62	86	91
INDMNTY:	99085	435904	1028584	1911760	2156960
AVG.CLM: (no inflation)	5215	10897	16590	22230	23703
AVG.CLM: (MCI):	5215	12041	20256	28500	35338
(HCE):	5215	12325	21221	32161	38784

The last two lines of the above chart reflect the potential for apparently startling magnitudes of growth of the average claims of young malpractice insurance companies in an inflationary society in a situation in which the actually severity of claims is not increasing.

(17) Because the HEW/Industry Study groups all claims closed more than four years after the incident in one category, the estimates for average claim and frequency are very rough estimates. The reader is asked to bear in mind that this chart is for illustrative purposes only.

When one examines other admittedly rough indicators of the growth of claims severity, one finds ample evidence to disprove any claims of remarkable growth in verdicts and settlements. For example, the average growth rate of incurred costs per claim against physicians and surgeons was 12.4 percent per year from 1971-1978, again, exactly within the range of the growth of health care costs. (18)

Another measure of severity is the size of jury verdicts. This is a very uncertain measure because data is incomplete and average jury verdicts fluctuate wildly from one year to the next. (19) However, whether you take the long view or the short view, malpractice verdicts have generally risen at or below the rate of increase in health care expenditures:

> From 1981 through 1984, the average malpractice verdict increased at an annual rate of only 3.9%, while the mid-point verdict actually decreased at the rate of 3.5%. Health care expenditures increased at a rate of 11.8% during that period.
>
> From 1977 through 1984, on the other hand, the average malpractice verdict increased at an annual rate of 14.7%, and the mid-point by only 8.7%. Health care expenditures increased at a rate of 13.1% for that 7-year period. (20)

One component of the claim that jury verdicts are

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(18) Danzon, P.M., "The Frequency and Severity of Medical Malpractice Claims," The Institute For Civil Justice, Rand Corporation (1982) p. 7.

(19) To say that these fluctuations in award averages provide ample opportunity for statistical mischief is to understate the danger. A recent column by James Kirkpatrick (March 5, 1985) reported that malpractice verdicts in California had skyrocketed, citing an Insurance Information Institute figure prominently featured in the AMA Report I (p. 21) that the average verdict had risen from $257,222 to $649,210 from 1982 to 1983. An examination of that publication reveals that 1983 was a quite unusual year for high verdicts (64% higher than any other year), and that 1982 was an unusual year for low verdicts, (the lowest since 1978). In fact, in 1984, according to these same sources the average California malpractice dropped 39% to $396,662. "California Superior Court Verdicts - Medical Malpractice Cases 1972 - 1984, Insurance Information Institute.

(20) "Injury Valuation Reports," No. 292, Jury Verdict Research, Inc. (1985), p. 18; Census.

grossly distorted asserts that juries are increasingly likely to award large verdicts out of sympathy, not because the facts of a case merit a large verdict. In fact, researchers have consistently found that, by and large, jury verdicts in malpractice claims are based primarily on rational decisions about actual injuries to malpractice victims, (21) and, in fact, generally undercompensate the victim of medical carelessness. (22)

(21) Danzon, P.M., "An Economic Analysis," supra at p. 44 (1983).
(22) "Medical Malpractice Claims: Synopsis of the HEW/Industry Study," supra at p. VI-3.

INVESTMENT INCOME AND THE MALPRACTICE INSURANCE INDUSTRY

As we have seen, the recent, sometimes severe, increases in medical malpractice premiums have virtually nothing to do with either the frequency with which malpractice claims are being filed, or with the size of jury verdicts. This perhaps has never been made more clear than this year, as the following news has been revealed:

> In 1984, insurance industry's own estimate of incurred loss and loss expense payments increased by the smallest amount since 1977. Yet, at the same time as the rate of growth of losses was declining, premiums increased by the largest margin since 1976, over 13%. (47)

To understand what lies behind the fluctuations in malpractice premiums, it is important first to appreciate the role of investment income in the medical malpractice insurance industry. While such income is important to any property/casualty insurer, it is truly the lifeblood of the medical malpractice insurer. The fact that malpractice claims are paid relatively slowly compared to claims in other lines of insurance leads to the creation of comparatively high loss and loss expense reserves, which in turn leads to a heavy reliance on investment income by malpractice insurers. From 1980 through 1983, malpractice investment gain was between 29% and 43% of premiums earned, while such income for the entire property/casualty insurance industry ranged between only 7% and 10% of premiums earned. (48) Further evidence of the magnitude of investment income in malpractice insurance can be found in the fact that, as of December 31, 1984, the malpractice insurance industry had earned, on assets encumbered by reserves for the occurrence years 1979-1984, over $330 million more in investment income than it had paid to victims of medical negligence. (49) Medical

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(47) A.M.Best's Casualty Loss Reserve Development, 1985.

(48) Best's Aggregates and Averages, 1984, supra, pp. 4-5.

(49) "Investment Income Analysis of Medical Malpractice Insurance," Public Affairs Department, Association of Trial Lawyers of America, October 1985; A.M.Best's, supra.

Liability Mutual Insurance Company, the largest malpractice insurer in New York and the second largest malpractice insurer in the nation, has, for occurrence years 1976-1984, in investment income on assets encumbered by reserves, over $210 million more than it has paid to victims. (50)

Traditional underwriting practices focus on estimates of incurred losses and loss expenses without regard to anticipated investment income, and therefore overstate liabilities in the form of reserves for known claims and reserves for claims incurred but not reported. The U.S. General Accounting Office recognized this practice in a report released earlier this year (51), concluding that property/casualty insurers in general, and medical malpractice insurers in particular, avoid paying their fair share of federal income taxes through accounting practices which allow insurers to fully deduct incurred losses, which includes reserves for future claims, thereby understating "the periodic determination of income for p/c companies," leading to a tendency to "overstate the amounts needed to satisfy future claims."

In other words, this tendency of the industry to overlook the role of investment income has allowed that industry to paint a unrealistically bleak picture of its losses, leading to high premiums and inappropriately low taxation. This phenomenon, however, does not explain the violently cyclical nature of medical malpractice premiums. The primary problem which, in some states, has led to sudden and substantial increases in medical malpractice premiums stems from the confluence of two factors: (1) The investment portfolio of the property/casualty insurance industry has suffered drastic decreases in its yield, and (2) that industry has, on the whole, ignored the gradual, normal increases in malpractice losses since 1977 and has instead based its premiums on competitive considerations rather than sound underwriting practices. Put another way, insurers have, over the last decade, paid too much attention to winning the war for "market share" and too little attention to paying for their losses. They were able to do this because their protective padding of high investment income insulated them from the consequences of their actions. Now that

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(50) Id.

(51) "Congress Should Consider Changing Federal Income Taxation Of The Property/Casualty Insurance Industry," United States General Accounting Office, GAO/GGD-85-10 (March 25, 1985) [Hereafter referred to as "GAO"].

interest rates have dropped, they not only can no longer charge too little for their product, they seem to feel that they must overcharge to compensate for their past mistakes. That is the primary reason that enormous malpractice premium increases are being imposed upon unsuspecting doctors from New York to California, from Texas to Wisconsin.

A closer look at the investment cycle is warranted here. All industries which involve investment are subject to cycles in which the yield of their investment portfolios rises and falls. The insurance industry is, however, prone to more extreme versions of these "profitability cycles" than are most other industries (52) because as much as 55% of the industry's assets are invested in bonds. (53) In a nutshell, the property/casualty insurance industry is now, as it was in 1974, in the depths of a rather severe decline the the yield of its investment portfolio. It is clear that this happened a decade ago:

> "In 1974, the Dow Jones Index of Industrial Stocks fell 400 points. Stock companies in the property-liability insurance industry reported a capital loss of $10 billion, four times as large as any previously on record. These adverse investment and underwriting results combined to reduce the yield of insurers' capital by over 26%." (54)

The net effect was to reduce the incentive of insurers to take risks and to increase the incentive to raise premiums - the dual crises of availability and cost. (55) Observers of the industry, understanding this relationship between this "cycle of profitability" and premiums, predicted in the early 1980's that, once interest rates started to fall significantly, premiums would once again rise, probably sharply. (56) As we have seen, they were correct.

This "boom-bust" cycle in the insurance industry is reflected in the behavior of insurers:

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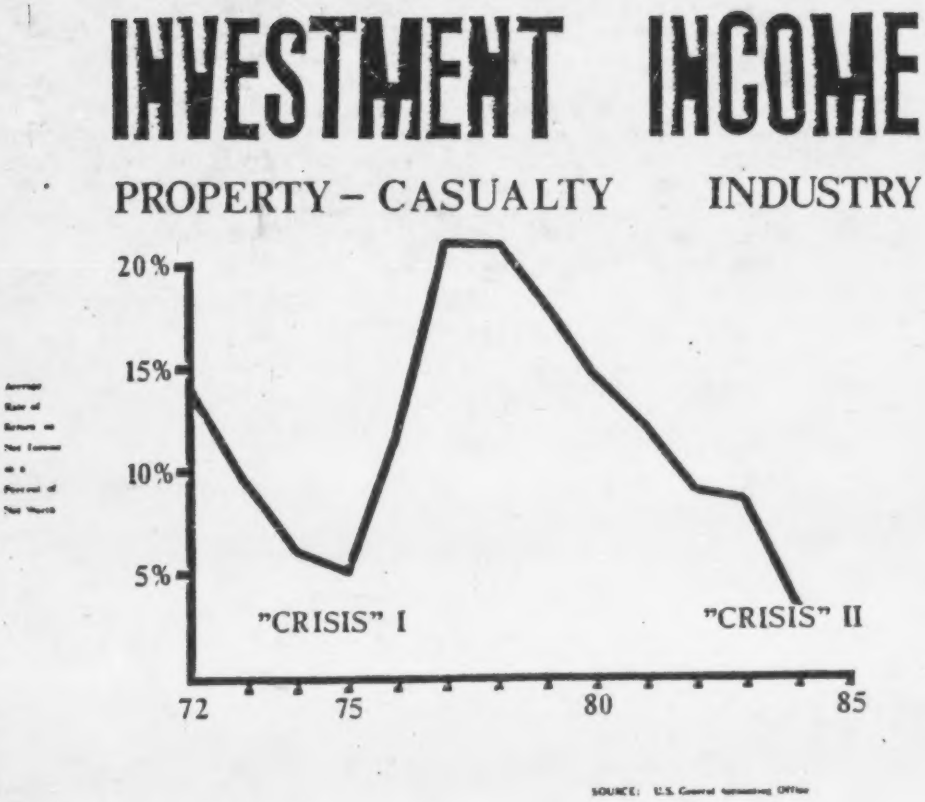
(52) Id. at p. 7; Conning and Company, "A Study of Why Underwriting Cycles Occur," (November 1979) p. 1.
(53) Best's Aggregates & Averages, Property-Casualty, 1985, p. 2.
(54) Danzon, P.M., "An Economic Analysis of The Medical Malpractice System," supra, p. 49.
(55) Id.
(56) Id.

> "It is amazing to see what happens in an insurance cycle to the mental state of underwriters. At the top of the cycle, in 1981, insurers were willing to not only take all of the risks they are shunning today, but were willing to go so far as to insure the liability of MGM after their Grand Hotel burned down. Compare that with today's doomsday attitude toward risks that the underwriters have subjectively declared to be taboo." (57)

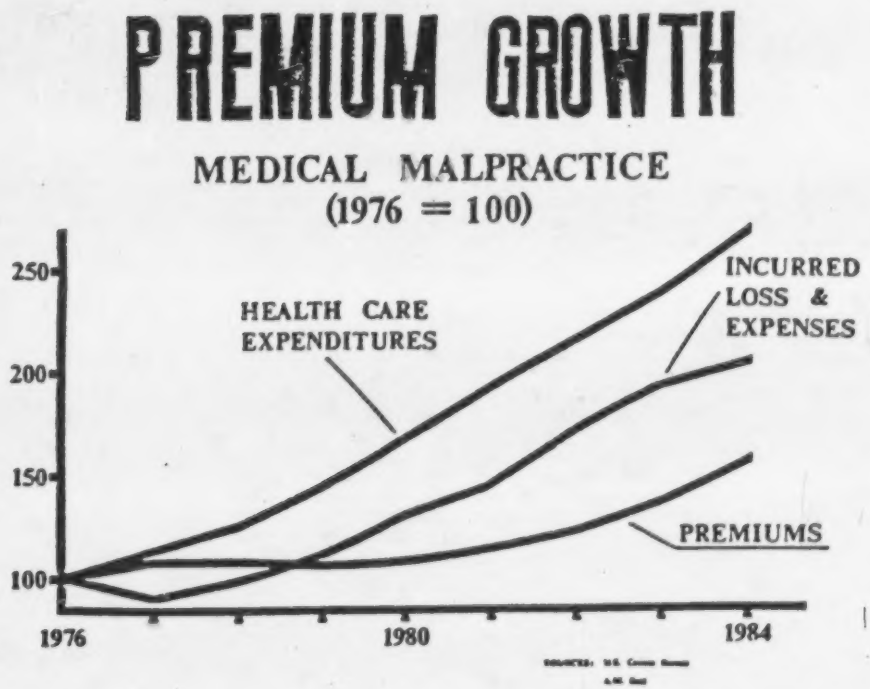
This cycle of profitability for insurers can be seen in the following chart showing annual rates of return from 1972-1984.

(57) "The Insurance Crisis of 1985: What Can Be Done?" National Insurance Consumers Organization (June 1985) p. 2.



The fact that the property/casualty insurance industry is at the bottom of a profitability cycle is only part of the story of skyrocketing premiums, however. Insurers have been far more interested in slashing prices to grab larger and larger shares of the malpractice "pie" than in providing their insured doctors and hospitals with sensible underwriting and stable premium growth. Often this competition has been between the established stock companies who dominated the market before 1975 and the newer doctor-owned companies, but even in those states where a doctor-owned company dominates the insurance market, there has been intense competition. (58) The effects of this

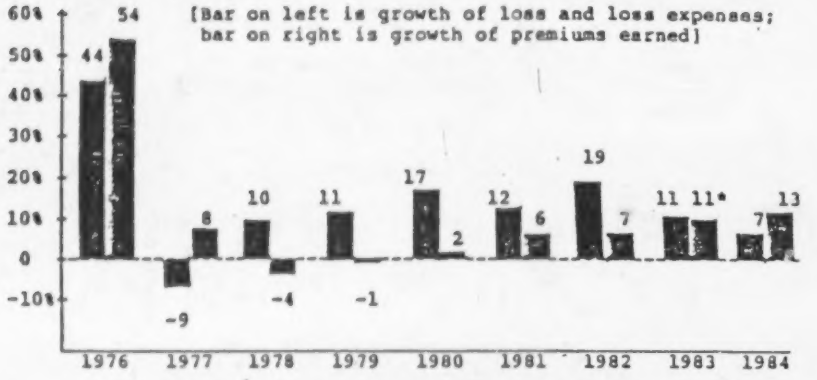
competition on premiums can be illustrated in several ways. First, a simple comparison of the growth in premiums and the growth in the industry's own estimates of incurred loss and loss expenses shows that premiums simply have not kept up with the normal growth in incurred losses. This can be clearly seen in the following graph, which includes the growth in the cost of health care to demonstrate that incurred losses have grown relatively slowly.



The odd news, from an underwriting perspective, that 1984 was the first year since 1977 that the growth in premiums earned kept up with incurred loss and loss expenses is revealed by the following graph.

(58) Danzon, P.M., "Why Are Malpractice Premiums So High, Or So Low," Rand Corporation 1978, p. 3.

RATE OF GROWTH - 1976-1984 (59)
EARNED PREMIUMS AND INCURRED LOSS AND LOSS EXPENSES



* - Because the figures are rounded for purposes of the graph, they do not reflect that, in 1983, incurred loss and loss expenses rose by 11.12%, while premiums rose only 11.07%.

This failure of insurers to adequately raise premiums to keep up with losses year after year has put insurers further and further behind the normal growth of losses from increases in the cost of living. This failure represents industry-wide irresponsibility in underwriting. As the President of the Continental Corporation recently said:

> "The proper role of the underwriter, as opposed to the recent tendencies of malpractice insurers, is "properly evaluating risk and avoiding the temptations of the marketplace that divert the underwriter's attention from the bottom line." (60)

(59) Best's Aggregates & Averages, 1979-1984; Best's Casualty Loss Reserve Development, 1979-1984.
(60) John Bretherick, Jr., President, Continental Corp., in an interview in "Property/Casualty Executives Speak Out," 85 Best's Review, Property/Casualty Insurance Edition 18, 19 (July 1985).

As long as investment income was relatively high, the industry did not have to face the consequences of its underwriting practices. However, as interest rates dropped the past two years, reducing the yield of the industry's investment portfolio, the cumulative effect of this poor underwriting caught up with insurers, inducing them to begin to raise rates. The steepness of recent rate hikes reflects, then, not just a return to proper ratemaking, but an overcompensation for past underwriting errors. As one industry observer recently commented:

> "The insurance companies themselves have exacerbated the malpractice crisis. The high investment yields of the early 1980's and the influx of new carriers led to continued price- cutting. In late 1984, and particularly in 1985, the strong dollar reduced the amount of insurance and reinsurance capacity available from London, and emerging losses in the U.S. finally forced companies to raise premiums." (61)

Thus are insurance "crises" created: overly competitive and fiscally careless insurers, virtually unregulated and untaxed, keep premiums low during times of high investment yield, only to be forced to overcompensate with enormous premium increases and limited or non-existent underwriting in riskier lines. All in the name of a non-existent increase in losses.

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(61) Posner, J.R., Marsh & McLennan, "Trends in Liability Insurance," Abstract from Presentation at National Medical Malpractice Conference, The Urban Institute (February 21-22, 1985).

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March 14, 1986

Ms. Tracy Crowley
Senate Committee on Small Business
428A Russell Bldg.
Washington, DC 20510

Re: Senate Hearings - Rapid City, SD

Dear Ms. Crowley:

I am enclosing the information I earlier referred to regarding malpractice premiums collected and claims paid in the State of South Dakota.

As you can see from reviewing the enclosures, earned premium for the year 1984 was $5,781,130, while claims paid equaled only $1,741,710. In other words, claims paid only amounted to 30.3% of the money earned by the insurance carriers. Earned premium in 1983 equaled $4,920,485 while claims paid equaled $1,130,924, or a total of 22.98% of the money earned by the companies.

We also have figures for the years 1980, 1981, and 1982:

Year	Premium Earned	Claims Paid	Percentage
1982	$ 4,430,226	$ 1,290,721	29.13%
1981	4,379,418	1,446,275	33.02%
1980	4,275,341	896,648	20.97%

The five-year average on these figures reflects that only 27.35% of the money earned by insurance companies was paid out in claims.

Thank you. Please contact me if you have any questions or comments.

Sincerely yours,

LYNN, JACKSON, SHULTZ & LEBRUN, P.C.

Gary D. Jensen

GDJ:rjm

enc.

[illegible]
MEDICAL MALPRACTICE
1984

COMPANY GROUP	DIRECT PREMIUMS WRITTEN	DIRECT PREMIUMS EARNED	POLICYHOLDER DIVIDENDS	DIRECT LOSSES PAID	DIRECT LOSSES INCURRED	DIRECT LOSSES UNPAID	ADJ. LOSS RATIO	MKT. SHARE
ALLSTATE INS GROUP	-368	13,290	0	0	4,400	11,840	33.108	-0.00
CHUBB GRP OF INS COS	8,256	26,412	0	186,940	-54,241	113,918	-99.999	0.12
CONTINENTAL CORP	4,278	2,329	0	200,000	-114	21,148	-4.490	0.06
CNA INS GROUP	156,051	140,903	0	0	330,643	502,290	234.660	2.42
NAUSAU INS COMPANIES	0	0	0	0	0	25,000	0.000	0.06
FIREMAN'S FUND GROUP	26,632	26,039	0	0	5,682	25,354	22.512	0.4
* HARTFORD INS GROUP	3,442	3,036	0	0	-9,167	6,761	-99.999	0.03
HOME INS GROUP	580	337	0	0	0	0	0.000	0.00
RELIANCE INS GROUP	0	31	0	0	0	0	0.000	0.00
ST PAUL GROUP	4,282,637	3,910,916	0	1,036,005	162,722	4,972,668	4.161	58.02
ORION GROUP	9,140	8,052	0	300	882	7,284	10.954	0.10
TRAVELERS INS GROUP	-445	-241	0	0	-995	0	412.863	-0.00
UNITED STATES F&G GR	269	257	0	60,000	48,100	12,600	999.999	0.06
ZURICH INS GROUP	0	762	0	0	145	1,120	19.029	0.01
BENEFICIAL STD GROUP	70,000	55,417	0	0	34,758	34,758	62.721	1.38
CAPITOL INDEMN CORP	1,771	1,903	0	0	0	0	0.000	0.07
CHURCH MUTUAL INS	2,443	3,288	0	0	0	0	0.000	0.03
CORM CREDIT GROUP	0	0	0	0	55	55	0.000	0.00
DRUGGISTS MUTUAL INS	13,218	12,545	1,289	0	-284	816	-2.523	0.27
INTEGRITY INS CO	5,210	4,707	0	0	1,039	1,705	22.074	0.05
MCN CORP GROUP	4,030	3,516	0	0	-2,925	192	-83.191	0.06
BERKSHIRE HATHAWAY	551	502	0	0	27	101	5.378	0.00
WESTERN INS GROUP	4,077	4,257	0	1,500	110,735	125,243	999.999	0.06
WESTCO INS GROUP	17,519	21,040	0	112	-4,929	29,369	-22.952	0.27
CIGNA GROUP	42,212	28,557	0	0	-13,891	47,066	-48.645	0.65
INS CORP OF AMERICA	601,940	547,756	0	102,500	57,611	298,936	10.519	9.74
EVANSTON GROUP	46,785	34,343	0	0	-40,444	52,054	-99.999	0.75
AMCO INS GROUP	3,226	3,086	0	0	3,441	7,599	111.504	0.05
PRUDENTIAL OF AM GRP	53	53	0	0	-559	2,291	-99.999	0.00
JEFFERSON INS GROUP	17,982	18,533	0	0	914	1,919	4.932	0.27
AETNA LIFE & CAS GRP	10,474	18,322	0	101,000	-76,309	154,226	-99.999	0.15
EMPLOYERS REINS GRP	0	0	0	0	0	251	0.000	0.00
PROFESSIONAL MUTUAL	9,058	9,425	0	0	7,263	13,475	78.122	0.14
GREAT GLOBAL ASSUR	847,385	706,393	0	1,372	187,989	240,939	26.613	13.15
AMER FINANCIAL GROUP	3,445	2,792	0	0	1,991	1,991	71.311	0.05
NAT CHIROPRACTIC MUT	40,262	40,039	7,644	0	-26,482	34,968	-91.747	0.62
HAYDEN INC GROUP	74,051	83,465	0	0	343,295	854,253	411.244	1.14
IOWA NATIONAL GROUP	75	186	0	0	0	0	0.000	0.00
TELEDYNE GROUP	18,719	24,322	0	51,781	-22,297	84,194	-91.674	0.15
AMER INTERN GROUP	4,961	4,891	0	0	149	1,950	3.446	0.07
LINCOLN NAT CORP	75	75	0	0	0	0	0.000	0.00
CALM AND FORSTER	19,109	19,244	0	0	-125,579	275,174	-99.599	0.29
TOTALS	6,443,103	5,781,138	8,933	1,741,710	923,705	3,932,551	14.307	100.00

* Inc Hartfords combined 30.3%

5yr average 27.35%

SOUTH DAKOTA
MEDICAL MALPRACTICE
1983

COMPANY GROUP	DIRECT PREMIUMS WRITTEN	DIRECT PREMIUMS EARNED	POLICYHOLDER DIVIDENDS	DIRECT LOSSES PAID	DIRECT LOSSES INCURRED	DIRECT LOSSES UNPAID	ADJ. LOSS RATIO	MKT. SHAR
ALLSTATE INS GROUP	29,800	16,141	0	0	7,400	7,400	45.846	0.57
CHUBB GRP OF INS COS	43,073	42,909	0	9,995	295,145	355,099	687.839	0.82
CONTINENTAL CORP	360	1,036	0	0	200,000	221,262	999.999	0.00
CNA INS GROUP	100,955	120,646	0	541	122,005	171,647	100.959	1.94
WAUSAU INS COMPANIES	0	0	0	0	25,000	25,000	0.000	0.00
FIREMAN'S FUND GROUP	24,941	23,262	0	0	-4,352	19,492	-18.709	0.48
HARTFORD INS GROUP	5,789	5,973	0	0	-47,672	15,329	-99.999	0.11
HOME INS GROUP	60	40	0	0	0	0	0.000	0.00
RELIANCE INS GROUP	81	81	0	0	0	0	0.000	0.00
ST PAUL GROUP	3,519,709	3,379,545	0	880,002	1,103,292	3,845,953	32.646	67.76
ORION GROUP	8,508	9,018	0	0	3,652	6,702	40.497	0.16
TRAVELERS INS GROUP	1,995	1,773	0	0	995	995	56.120	0.03
UNITED STATES F&G GR	356	256	0	175,000	-24,900	24,500	-99.999	0.00
ZURICH INS GROUP	2,044	1,961	0	0	-1,292	975	-65.936	0.03
AMER UNIVERSAL GROUP	0	0	0	0	1	0	0.000	0.00
CAPITOL INDEMN CORP	2,003	2,278	0	3,000	1,000	0	43.898	0.2
CHURCH MUTUAL INS	3,469	3,823	0	0	0	0	0.000	0.06
DRUGGISTS MUTUAL INS	12,161	11,840	1,023	0	-100	1,100	-9.924	0.2
INTEGRITY INS CO	4,447	4,441	0	0	43	666	0.968	0.08
MCA CORP GROUP	703	384	0	0	3,117	3,117	811.719	0.01
BERKSHIRE HATHAWAY	439	374	0	0	15	74	4.011	0.00
WESTERN INS GROUP	4,894	4,614	0	25,000	28,295	25,963	613.242	0.7
WESTCO INS GROUP	24,722	27,307	0	0	2,073	24,250	10.521	0.51
CIGNA GROUP	21,069	24,226	0	0	15,424	60,957	63.405	0.40
INS CORP OF AMERICA	508,096	491,791	0	0	115,653	242,725	23.395	9.78
COLUMBUS INS CO	1,089	2,056	0	0	0	0	0.000	0.0
EVANSTON GROUP	79,486	66,825	0	0	49,999	92,498	74.821	1.53
AMACO INS GROUP	2,160	4,715	0	0	-5,968	4,158	-99.999	0.04
PRUDENTIAL OF AM GRP	-666	281	0	0	-3,065	2,952	-99.999	-0.01
JEFFERSON INS GROUP	16,146	17,609	0	0	-43	1,005	-0.244	0.31
AETNA LIFE & CAS GRP	23,528	20,891	0	0	148,063	552,046	708.741	0.45
EMPLOYERS REINS GRP	0	0	0	0	0	251	0.000	0.00
PROFESSIONAL MUTUAL	10,557	12,461	0	30,000	-73,882	6,112	-99.999	0.20
GREAT GLOBAL ASSUR	330,619	428,025	0	0	154,321	154,321	36.054	10.60
NAT CHIROPRACTIC MUT	38,495	39,159	8,397	321	33,486	60,571	108.790	0.74
MAYBEN INC GROUP	96,962	95,949	0	4,000	262,979	511,008	272.144	1.36
IOWA NATIONAL GROUP	227	138	0	0	0	0	0.000	0.00
TELEDYNE GROUP	28,786	32,704	0	3,065	98,546	158,472	276.365	0.55
AMER INTERN GROUP	4,361	4,518	0	0	69	1,807	1.527	0.08
LINCOLN NAT CORP	75	75	0	0	0	0	0.000	0.00
CRUM AND FORSTER	19,766	21,060	0	6	-833,114	360,353	-99.999	0.28
TOTALS	5,194,125	4,920,485	9,420	1,130,924	1,667,461	8,859,586	33.753	100.00

22.98%

SOUTH DAKOTA
MEDICAL MALPRACTICE
1982

COMPANY GROUP	DIRECT PREMIUMS WRITTEN	DIRECT PREMIUMS EARNED	POLICYHOLDER DIVIDENDS	DIRECT LOSSES PAID	DIRECT LOSSES INCURRED	DIRECT LOSSES UNPAID	ADJ. LOSS RATIO	MK SH
CHUBB GRP OF INS COS	41,084	38,264	0	36,624	55,395	69,949	144.771	0.
CONTINENTAL CORP	2,124	2,646	0	0	500	21,262	18.896	0.
CNA INS GROUP	54,609	56,069	920	0	20,144	50,183	36.527	1.
FIREMAN'S FUND GROUP	25,288	27,394	0	0	9,095	23,845	33.201	0.
HARTFORD INS GROUP	2,906	11,042	0	0	3,982	63,602	36.062	0
HOME INS GROUP	29	24	0	0	0	0	0.000	0.
RELIANCE INS GROUP	81	81	0	0	0	0	0.000	0.
ST PAUL GROUP	3,238,115	3,458,995	0	1,223,585	1,022,985	5,622,665	29.575	74.
OHIO GROUP	7,918	7,448	0	0	1,526	3,050	20.489	0.
SENTRY INS GROUP	7,220	6,196	0	0	595	722	9.603	0
UNITED STATES F&G GR	122	459	0	0	110,098	224,400	999.999	0
ZURICH INS GROUP	1,881	2,475	0	3,561	1,025	2,268	41.414	0
AMER UNIVERSAL GROUP	0	0	0	0	-12	1	0.000	0.
CAPITOL INDEMN CORP	1,471	4,879	0	0	2,000	2,000	40.992	0.
CHURCH MUTUAL INS	3,552	3,641	0	0	0	0	0.000	0.
DRUGGISTS MUTUAL INS	11,238	10,664	752	0	200	1,200	2.018	0.
INTEGRITY INS CO	4,348	4,151	0	0	249	623	5.999	0.
BERKSHIRE HATHAWAY	439	296	0	0	59	59	19.932	0.
WESTERN INS GROUP	5,530	6,142	0	5,250	8,722	22,368	142.066	0.
WESTCO INS GROUP	30,745	26,414	0	0	11,420	31,377	43.225	0.
CIGNA GROUP	38,378	39,593	0	0	-114,311	45,532	-99.999	0
INS CORP OF AMERICA	501,014	396,060	0	0	105,168	228,672	26.554	11.
EVANSTON GROUP	68,844	51,440	0	0	8,920	42,499	17.341	1
ARMCO INS GROUP	5,449	4,377	0	0	8,425	10,126	192.482	0
PRUDENTIAL OF AM GRP	1,387	652	0	0	3,825	6,017	585.758	0
JEFFERSON INS GROUP	19,040	13,352	0	0	-186	1,048	-1.392	0
AETNA LIFE & CAS GRP	16,959	15,845	0	0	54,838	193,781	346.090	0.
EMPLOYERS REINS GRP	0	0	0	0	251	251	0.000	0.
PROFESSIONAL MUTUAL	15,599	14,788	0	0	665	109,494	4.497	0.
NAT CHIROPRACTIC MUT	42,195	42,358	8,987	501	-32	27,426	-0.096	0.
HAYDEN INC GROUP	89,853	91,603	0	16,000	-2,342	252,929	-2.884	2
IOWA NATIONAL GROUP	100	100	0	0	0	0	0.000	0
TELEDYNE GROUP	77,272	69,792	0	5,200	58,100	70,991	83.247	1
AMER INTERN GROUP	4,686	4,344	0	0	922	1,737	21.225	0.
LINCOLN NAT CORP	75	46	0	0	0	0	0.000	0.
CRUM AND FORSTER	20,743	18,595	0	0	1,182,399	1,193,667	999.999	0.
TOTALS-	4,340,214	4,438,226	10,659	1,290,721	2,554,325	8,314,744	57.196	100.

29.13%

SOUTH DAKOTA
MEDICAL MALPRACTICE
1981

COMPANY GROUP	DIRECT PREMIUMS WRITTEN	DIRECT PREMIUMS EARNED	POLICYHOLDER DIVIDENDS	DIRECT LOSSES PAID	DIRECT LOSSES INCURRED	DIRECT LOSSES UNPAID	ADJ. LOSS RATIO	MKT. SHARE
CHUBB GRP OF INS COS	34,518	32,730	0	6,802	-41,322	51,178	-99.999	0.758
CONTINENTAL CORP	4,334	2,996	0	0	2,457	20,762	88.685	0.095
CNA INS GROUP	56,116	55,619	1,577	0	9,459	30,039	17.583	1.230
FIREMAN'S FUND GROUP	23,741	16,335	0	325	5,828	14,749	35.246	0.520
HARTFORD INS GROUP	62,172	53,933	0	20,200	2,705	59,619	5.015	1.362
HOME INS GROUP	15	18	0	0	0	0	0.000	0.000
AMER GENERAL GROUP	0	0	0	0	-418	0	0.000	0.000
RELIANCE INS GROUP	81	81	0	0	0	0	0.000	0.002
ST PAUL GROUP	3,737,695	3,636,208	0	707,187	745,433	5,823,266	20.500	81.899
ORION GROUP	6,182	4,487	0	0	-459	1,524	-10.230	0.135
SENTRY INS GROUP	2,660	632	0	0	127	127	20.095	0.056
UNITED STATES F&G GR	1,741	19,583	0	486,384	446,679	114,302	999.999	0.038
ZURICH INS GROUP	4,655	5,086	0	0	2,006	4,804	39.442	0.102
AMER UNIVERSAL GROUP	0	0	0	0	-36	13	0.000	0.000
CAPITOL INDEMN CORP	7,959	8,056	0	0	0	0	0.000	0.171
CHURCH MUTUAL INS	3,913	5,571	0	0	0	0	0.000	0.084
DRUGGISTS MUTUAL INS	10,392	10,916	394	0	-2,000	1,000	-19.008	0.221
INTEGRITY INS CO	2,630	1,289	0	0	-416	374	-32.273	0.057
WESTERN INS GROUP	1,857	8,584	0	0	-32,011	19,196	-99.999	0.041
WESTCO INS GROUP	26,693	26,387	0	0	7,585	19,957	28.745	0.587
UMI GROUP	[redacted]	-91	0	0	0	0	0.000	0.000
CIGNA GROUP	17,543	34,982	0	217,856	-22,810	159,844	-65.205	0.384
NORTHEASTERN FIRE PA	-1,173	715	0	0	253	253	35.385	-0.027
INS CORP OF AMERICA	269,808	168,291	0	0	119,626	123,504	71.083	5.911
COLUMBUS INS CO	-180	-208	0	0	0	0	0.000	-0.001
EVANSTON GROUP	35,697	28,333	0	0	28,165	33,579	99.407	0.781
ARMCO INS GROUP	4,543	5,562	0	0	-546	1,701	-9.817	0.101
PRUDENTIAL OF AM GRP	3,652	3,500	0	0	2,192	2,192	62.629	0.084
JEFFERSON INS GROUP	11,321	8,852	0	0	-421	1,234	-4.756	0.251
AETNA LIFE & CAS GRP	9,921	9,122	0	0	-39,422	129,142	-99.999	0.211
PROFESSIONAL MUTUAL	12,446	13,131	0	0	101,595	109,329	772.527	0.271
NAT CHIROPRACTIC MUT	52,786	52,896	4,291	2,500	7,526	27,959	15.484	1.151
HAYDEN INC GROUP	82,872	108,649	0	5,000	-39,295	271,571	-36.167	1.814
IOWA NATIONAL GROUP	100	100	0	0	0	0	0.000	0.002
TELEDYNE GROUP	70,653	52,376	0	101	4,898	18,091	9.352	1.541
AMER INTERN GROUP	2,717	2,037	0	0	-711	814	-34.904	0.066
CRUM AND FORSTER	4,043	2,440	0	0	-2,094	11,268	-85.829	0.083
TOTALS	4,564,225	4,379,418	6,262	1,446,275	1,304,773	7,051,391	29.836	100.000

33.07

SOUTH DAKOTA
MEDICAL MALPRACTICE
1980

COMPANY GROUP	DIRECT PREMIUMS WRITTEN	DIRECT PREMIUMS EARNED	POLICYHOLDER DIVIDENDS	DIRECT LOSSES PAID	DIRECT LOSSES INCURRED	DIRECT LOSSES UNPAID	ADJ. LOSS RATIO	MKT. SHARE
CHUBB GRP OF INS COS	34,192	33,010	0	13,326	-26,955	99,382	-81.657	0.782
CONTINENTAL CORP	4,666	3,223	0	0	2,385	18,105	73.999	0.107
CNA INS GROUP	53,342	31,127	7,383	0	1,113	20,580	4.688	1.220
FIREMAN'S FUND GROUP	11,737	11,891	0	3,000	-1,113	9,245	-9.360	0.269
HARTFORD INS GROUP	966	93,804	0	0	21,866	77,113	23.310	0.022
HOME INS GROUP	164	366	0	0	0	0	0.000	0.004
AMER GENERAL GROUP	245	252	0	0	-57	418	-22.619	0.006
RELIANCE INS GROUP	81	81	0	0	0	0	0.000	0.002
ST PAUL GROUP	3,777,990	3,565,242	0	537,341	1,402,668	5,785,019	39.343	86.421
ORION GROUP	9,116	9,346	0	0	-1,030	1,983	-11.021	0.209
TRAVELERS INS GROUP	0	0	0	44	44	0	0.000	0.000
UNITED STATES F&G GR	26,173	29,728	0	0	35,380	153,927	119.012	0.599
ZURICH INS GROUP	5,870	5,878	0	0	1,023	2,798	17.404	0.134
AMER UNIVERSAL GROUP	-137	28	0	0	-36	50	-99.999	-0.003
CAPITOL INDEMN CORP	7,307	6,906	0	0	0	0	0.000	0.167
CHURCH MUTUAL INS	6,513	4,896	0	0	0	0	0.000	0.149
COMM CREDIT GROUP	0	0	0	0	-200	0	0.000	0.000
DRUGGISTS MUTUAL INS	11,328	11,836	0	0	0	3,000	0.000	0.259
INTEGRITY INS CO	1,499	5,387	0	0	307	790	5.699	0.034
OHIO CASUALTY GP	0	0	0	0	-12	0	0.000	0.000
WESTERN I&S GROUP	20,752	21,529	0	123,114	97,479	51,207	452.780	0.475
WESTCO IN: GROUP	17,430	24,844	0	0	-2,161	12,372	-8.698	0.399
UNI GROUP	1,083	1,193	0	0	0	0	0.000	0.025
CIGNA GROUP	60,714	59,949	0	0	329,424	400,508	549.507	1.389
INS CORP OF AMERICA	24,665	6,950	0	0	3,878	3,878	55.799	0.564
EVANSTON GROUP	4,298	3,904	0	0	2,192	5,414	56.148	0.098
ARMCO INS GROUP	6,916	7,761	0	0	-326	2,247	-4.200	0.156
JEFFERSON INS GROUP	6,707	6,940	0	0	505	1,655	7.277	0.153
AETNA LIFE & CAS GRP	26,887	62,769	0	174,607	-96,162	168,564	-99.999	0.615
PROFESSIONAL MUTUAL	13,433	13,850	0	44,716	44,716	0	322.859	0.367
NAT CHIROPRACTIC MUT	48,151	48,955	0	500	-7,842	22,933	-16.019	1.102
HAYDEN INC GROUP	159,926	179,827	0	0	61,278	315,865	34.076	3.658
IOWA NATIONAL GROUP	100	100	0	0	0	0	0.000	0.002
TELEDYNE GROUP	25,514	17,960	0	0	13,294	13,294	74.020	0.584
AMER INTERN GROUP	2,510	3,816	0	0	-27,420	1,526	-99.999	0.057
LINCOLN NAT CORP	230	326	0	0	0	0	0.000	0.005
CRUM AND FORSTER	1,334	1,667	0	0	3,009	13,362	180.504	0.031
TOTALS	4,371,592	4,275,341	7,383	896,648	1,857,247	7,185,155	43.516	100.000

20.977o

Senator PRESSLER. First of all, I thank you very much for the testimony you provided on behalf of the South Dakota Bar Association. This is exactly what we are doing, is trying to check out and get specific facts and we have asked the insurance industry for that. And this is exactly what we are doing. So I thank you very much.

Let me ask you a few questions. First of all, as you point out, indeed I did a newsletter on this and we tried to present the facts in it. Did you pretty much agree with the analysis we did in the newsletter?

Mr. JENSEN. I agreed with the part that talked about the cyclical nature of the insurance business and how the insurance industry cut its rates probably too low to get money into the money markets and make money at high interest rates.

I can't agree where you talked about large jury verdicts because nobody has ever proved that. Nobody in South Dakota, certainly, can talk about big jury verdicts.

Senator PRESSLER. On the cyclical question, this cyclical thing seems much deeper than past ones and is lasting longer, and no one can really see relief in the foreseeable future.

You mentioned on page 4—you mentioned of the word—you quoted from the Minneapolis Star the word, "greed." Would you say that this current cycle is deeper, and would you expand on that?

Mr. JENSEN. I don't think the current cycle is any deeper than it has been in the past. I think we are talking about a temporary economic condition that the fellow who is discussing the subject in Minneapolis—and apparently, the Rapid City Journal—believe will pass in the near future.

I can't forecast if interest rates are going to go back up.

Senator PRESSLER. We have heard testimony in Washington—and I'm not putting you on the spot at all—there seems to be a split in the American Bar Association. The corporate lawyers or the lawyers more practicing corporate law, whatever that term is, some of them testified on behalf of the product liability, but the trial lawyers testified against it. Is there a split in the South Dakota Bar Association on this, or is there a split in the American Bar Association?

Mr. JENSEN. I would be less than honest if I told you I knew exactly what the position of the State bar was, member for member. I don't think they have been polled, but I do think it is fair to say that the State bar as a whole, and certainly the vast majority, would agree that our basic legal system as it has been for 200 years—where the people as jurors decide what is right—is the system that we should keep.

Senator PRESSLER. As I understand it, in Europe, Japan, and most other countries contingency fees are outright illegal. Punitives are rare in civil cases except for Ireland.

There are no jury trials in civil cases of this sort. and so forth; this is kind of becoming an international trade issue and we try to compete for more commerce. If somebody wants to bring a lawsuit, they bring it to the United States. It's really become a problem in international trade, so to speak, because you can't—the legal practices are not the same.

Is there anything to be learned from our neighbors? They do not now have our insurance problems, and insofar as there being an insurance crisis or not, what I have been hearing in my office and as I go around my State, I would say there is an insurance crisis; so I would be in disagreement with you there. But most major reinsurers have simply quit insuring the American market, while other countries are unaffected.

I don't know if you have any comments on these comparative legal systems or if you want to submit something for the record.

Mr. JENSEN. It certainly doesn't hurt to study other countries, and I think part of the materials we have submitted with our written statement discusses what happens in other countries and supports the conclusion that people in this country do not sue substantially more or less than those in other countries.

I think the basic question is, who is going to decide? Somebody has to pay when somebody is injured or killed, and the question of who is going to decide that.

Are we going to keep juries of our peers deciding that or are we going to have government or bureaucrats or somebody else tell us that, and the bar association is of the opinion and takes the position that the jury system—which has served us for a long time and served us well—the jurors should continue making those decisions?

Senator PRESSLER. I tend to agree that, overall, South Dakota law is fair to the consumer, businessman, lawyer, et cetera, but we still find ourselves having to pay for the sins of other States as we have heard here this morning. Can this problem be resolved on a State-by-State basis or do we need uniform laws?

Mr. JENSEN. Well, as you mentioned before, the insurance industry is essentially exempt from Federal antitrust laws and regulation has been left to the State; and perhaps States have not done a very good job of that in the past and maybe it took something like this for States to get their act together to pass the necessary legislation to find out what, in fact, the facts are and go from that point.

So at the present time, the State bar would be against Federal intervention into the area for all the reasons that probably 90 percent of the people in this room are against Federal intervention into anything, and allow the States to try to handle the problem.

Senator PRESSLER. And indeed, you state it very well. Part of the problem is that a lot of these high verdicts are set by juries, and indeed we do have guarantee of right to trial by jury in our Constitution. On the other hand, juries are limited by laws passed by State legislators and by the Federal Government in many areas.

Indeed, a judge gives the jury instructions as to what the law is, so the jury can't do just anything. A jury has to do it within the law. So a law could be passed limiting punitive damages, just as a law is passed telling the jury that they can do things within certain realms of telling them what the law is.

So wouldn't you agree that a jury could be instructed as to a limitation on damages?

Mr. JENSEN. Certainly, you could do that if you wanted to. We are saying it would not be good to do that in that each case should be decided on a case-by-case basis.

When you talk about a verdict of $1 million, $1 million—no question about it—is a lot of money. But what happens when you have somebody who is run into at a stop sign, turned into a quadraplegic, and whose existing medical bills are $300,000 and it's going to cost $800,000 to take care of this person for the rest of his life? Somebody has to pay those bills. That's the society we live in. Medical costs are high. So should it be the person who ran the stop sign? Should he pay, or should society have to pay? We think the wrongdoer should have to pay.

Senator PRESSLER. I think Senator Hatch's bill wouldn't take away from that person his right to recover his medical expenses or career. It is in the area of punitive damages that he feels most of the largest things.

You could say each jury should decide. On the other hand, the State legislature is elected; the Congress is elected. They decide a lot of other laws. Maybe they should decide this. Maybe they should take this responsibility.

So it depends on how you are going to argue it. If you argue each jury can do anything they want, they are limited by the laws of the county, State and Federal Government, and by the higher court rulings. So a jury is really limited in what it can do. Punitive damages is one area where juries haven't been limited, and it's not the jury in this State. Everybody tries to transfer their case to New Jersey and California and a standard is set and everybody else has to pay that much.

So I would be in disagreement with you on two points. One, I think there is an insurance crisis—and I will give you plenty of time to respond—and two, I am doubtful that juries are doing this directly in this area and I don't see anything wrong with elected legislators taking responsibility for limitations.

You may respond to both of those, because I think you disagree.

Mr. JENSEN. With regard to limitation on punitive damages, $250,000 may be sufficient or more than sufficient to punish some wrongdoer, whether it be a person or company or manufacturer in a given case; because the purpose, after all, of punitive damages is to punish somebody for something that is outrageous and you don't want it to happen again because of the terrible consequences it has on people in this society. That is the theory behind punitive damages.

So there is no question in many cases, and perhaps most cases, $250,000 will hurt whoever it is that has done the wrong and, by God, they won't do it anymore.

But you take the company that is worth millions and billions of dollars; $250,000 isn't going to mean anything to them. You have to have the ability to proceed higher than the $250,000 if in fact you are going to punish those people and prevent them from doing that again.

That's why it's so hard to set limits to apply to everybody across the board in every case.

Senator PRESSLER. I'm not in any way trying to put you down or argue with you here, but we are trying to get facts out because there are a lot of safety things that have occurred that wouldn't have occurred without lawsuits, but the actual victim usually doesn't get the majority of these, or so I'm told. Maybe in South

Dakota they do. I am told they usually have to go through 3 to 5 years of lawsuit, during which time they live on their own moneys and so forth; and then whatever they recover is only a small portion of it.

One of my colleagues, Senator Dodd, has a bill which would set up an arbitration thing whereby they can waive their rights and get their repayment for medical and career losses and some other damages very quickly, but it's sort of an arbitration thing. They waive future rights and so forth. What would your reaction be to legislation such as that? What would your thinking about that be?

Mr. JENSEN. Other than that it is Federal intervention, which we are against, I think the vast majority of lawyers in South Dakota and the people of South Dakota and the people that have been hurt would be against legislation anywhere that limits recovery only to medical expenses or lost wages.

That leaves completely uncompensated the things—the rest of the things that happen, the emotional parts, the effect it has on your relationship with your family. Those are perhaps more important and should be compensated than pure medical bills, and if I understood your proposed legislation, that type of injury would not be compensated. And we couldn't agree with that.

Senator PRESSLER. What would you recommend that the State legislature or Federal legislature do in the coming session regarding the insurance—I call it crisis, or insurance problems?

Mr. JENSEN. Again, I think the State bar would at this point be against Congress doing anything, and at this point leaving it to the State legislature essentially to pass statutes that would require those in the insurance industry—and not all members of the insurance industry are claiming there is a crisis or problem—but allow those who think there is a problem and want to raise their rates based on the problem, pass statutes saying, come in here and tell us, since you are not to charge excessive rates. We want to know how much you have in premiums, how much you have actually paid out in claims—not the claims made, because there is a vast difference between claims made and claims paid—and tell us what you have made on your money.

Let's see what your bottom million is, and statutes like that do exist in other States and they should probably be passed in South Dakota. That's what we would like to see done.

Senator PRESSLER. Let me emphasize, on your last point, I am not talking about pain and suffering damages, only punitive. Senator Hatch's bill is aimed at punitive only. What would your reaction be to a limitation on punitives?

Mr. JENSEN. We would be against it for the reasons we would be against any type of limits in any case across the board because it doesn't allow a jury to take into account the facts of that particular case.

And $250,000 may simply not be enough money to get the big company's attention, which is the only way you get them to quit doing unsafe, terrible, horrible things, which are what punitive damages are designed for.

Senator PRESSLER. What would your position be on the product liability bill that was in Congress? Senator Kasten and I sponsored it, and maybe you are not familiar with it exactly but it would be

the first step toward setting a uniform standard for product liability. What would your position on that bill be?

Mr. JENSEN. Again, I guess we would be against Congress getting into something like that. We think it is a matter left to the States. I am not intimately familiar with it, so I can't discuss it in particular, but this matter has always been left to the States.

States like South Dakota should not have to pay for what's going on elsewhere. We should be allowed to conduct our own affairs.

Senator PRESSLER. Well, I thank you for your testimony. By the way, I have read the editorials; believe me, the Senators do read editorials from their own State, and I thank you very much for including them. I think your testimony and the editorials you have are information we should have.

One other point you make very interesting goes back to this question of—you state on page 5, they are especially conservative in small rural States like South Dakota. That's in terms of the jury verdicts. Would you say that in New Jersey and California, just from in general or some of those States, do you think some juries have gone overboard in the level of recovery?

Mr. JENSEN. It's pretty hard to say without, I guess, looking at each case, but I'm sure in cases juries award more money than people should be awarded. In other cases they probably award less.

Senator PRESSLER. But the point is, people paying insurance premiums really have to pay at a level that is set by that New Jersey and California level; is that not correct?

Mr. JENSEN. I guess that's what we are here to discuss and decide and figure out.

Senator PRESSLER. I thank you very much. We look forward to working with you in the future.

I guess we have Mr. Honerkamp.

STATEMENT OF WILLIAM HONERKAMP, PRESIDENT, SOUTH DAKOTA'S BLACK HILLS, BADLANDS, AND LAKES ASSOCIATION, RAPID CITY, SD

Mr. HONERKAMP. Thank you, Senator Pressler, members of the committee staff. I regret that I was not here when you called earlier; thank you for the opportunity.

My name is Bill Honerkamp, and I appear today as president of the South Dakota Badlands and Lakes Association. That organization represents about 504 different member businesses in western South Dakota. All of these businesses are involved in the tourism and travel industry. All of them are small businessmen. Like other sectors in the American economy, skyrocketing insurance rates are causing great concern among our members. Astronomical insurance renewal premiums are, at the very least, jolting operational budgets, and they are indeed actually driving some enterprises out of business.

Let me cite some examples. I can name three different trailride operators—saddle horses for rent—in the Black Hills and Badlands region which have simply quit the business in the last 12 months. They knew they could not show a profit after their insurance rates increased dramatically. The current rate to insure a single trailhorse for supervised pleasure riding is about $500 an animal.

This approximately doubled what the wranglers have been paying, and would require an operator to take at least 72 visitors riding on that 1 animal to make his insurance payments. That kind of overhead is unmanageable.

So these three trailrides—Hill City, Rapid City, and from Interior—have simply quit the business, sold off their saddle horses, sold off their equipment.

I could also cite a local ski area's rates that more than doubled from about $40,000 per year to almost $90,000 per year.

At another, a museum operator in Custer, the premium went from $2,500 to $7,000 this year; this, despite the fact that he has never had a claim against his insurance company, and is in a relatively low risk posture.

In my association's view there are four key factors we feel are responsible for these insurance hikes.

First, because of the favorable investment rates over the past few years, insurance companies have been less in the insurance business and more and more in the investment business. By reinvesting premiums they can pay handsome recovery claims, pay overhead, and show a profit.

Second, while insurance companies were receiving high yield from their investments they were able to insure high risks. With low interest rates, that's not possible. These first two factors are largely functions of a changing market——

Senator PRESSLER. I am going to leave the room for about 10 minutes. I have to be at KOTA for about 3 minutes. They are going to interview me on this subject and I am going to come back, but I am going to leave Kevin Schieffer, who is an expert on these matters, continuing your testimony and we have Dale Yeoman and Chris Schmid here. And I will be back, but why don't you proceed and Kevin will ask you some questions for me and I will step back into the room.

I made that commitment to them and they announced it in advance, so I better do it. This hearing has been so interesting and has run longer than it should be. I will be back. I better keep my commitment to them, but you continue to proceed.

Kevin will ask you my questions and we will call the last panel forth from the insurance industry, and I will be back. I shall return.

Mr. HONERKAMP. As I said—to reiterate, the first two points I felt were the cash-flow underwriting as well as insuring some high risks, and that is no longer possible. These factors are largely functions of the market and I do not believe that the Federal or State government should overreact with new controlling statutes.

After this period of adjustment—and certainly, it's a traumatic adjustment—I suspect it's reasonable to assume that insurance rates will begin to level out, will settle down, and I am not convinced that either State or Federal intervention would help on this account.

There are two other factors, however, which the Government may wish to address: limits of liability in terms of damages awarded, and also the limits of liability in terms of who can be sued. And allow me to explain.

In terms of damages, there must be some guidelines which could be established to determine the upper limits of financial liability. I think small businesses do accept the moral responsibility and the financial responsibility for restitution of personal expenses and tangible damages; however, there seems to be no limit to the cash amounts which can be awarded as a matter of sympathy for pain and suffering, mental anguish, and diminished enjoyment of life. It seems endless.

And because of the possibility for astronomical settlements, we suspect that there is some incidence of frivolous insurance claims in which claimants hope they can simply cash in on an accident for big bucks.

My fourth point is that the Government might also consider limiting the number of parties who might be sued for insurance damages. Today's insurance settlements typically bring claims against a long list of defendants. They include the business, insurance company, owners, employers, probably; its employees; in short, the claimant simply charges everyone remotely connected with that business. With sort of a legal machine gun, he sprays a hail of legal bullets and hopes to hit the right target at least once.

In the meantime all defendants, whether they are liable or not, have to take cover and defend themselves. That doesn't seem right because many parties are required to defend themselves needlessly.

I don't pretend to know the answer to this, but liability claims should be required to be narrowly focused by a plaintiff and not simply become some fishing expedition to see who might settle.

Kevin, I am going to end my remarks there and try to answer your questions.

Mr. SCHIEFFER. Thank you, Bill.

I might start out by apologizing first. I have a bit of a cold today, so I may be hard to understand.

With the tourism industry in particular, Bill, I might mention and give a little background first. One of the things that got Senator Pressler started on this issue originally—and this was over a year ago—in terms of the broader scope of the insurance problem was the tourism industry. As you know, Senator Pressler is chairman of the Tourism Subcommittee, and that committee has a national tourism advisory council comprising—made up of the top 15, 20 tourism industry leaders from around the country, 2 of which are from South Dakota. And most of you know Kay Riordan, who is on that committee, and Dennis Bail from Aberdeen. But this is an issue that they raised and made the comment that throughout the tourism industry, in terms of buses, in terms of the airlines, in terms of the hotels, just every segment of the tourism industry.

This runs across the board and it is something that counsel—as an advisor to Senator Pressler's subcommittee—recommended that he look into, and that is what started this in the Commerce Committee.

On a more general basis, you made mention of three, I believe, tourism industries in particular in South Dakota that have had big problems. What has been their claim experience in this area? Is there any relation, again, between the claims incurred or paid in the South Dakota industries as opposed to—or as compared to, I should say—what they have been paying in premium rates?

Mr. HONERKAMP. I think not. All of the operators I cited had admirable operating records. It does seem to me that South Dakotans are part of a national insurance pool, and I believe South Dakotans probably have a sort of singular sense of justice, even when cases go to court. I think we are a moderate thinking people and apparently much more conservative than other areas of the country.

But yes, the transport industry in particular has probably been the most seriously impacted on this, and of course the result of the bottom line does filter down to everyone because these all result in increased consumer costs. And there is an absolute inverse proportion there that the higher a service cost, the less likely it is to be purchased.

We have seen transportation rates go up. We have seen ski areas across this Nation apologizing for increasing their lift tickets and telling their customers that the entire proceeds of that increase are going to their insurance company, not into their own pockets.

Mr. SCHIEFFER. Tourism is the No. 2 industry in South Dakota, Bill. Could you just relay in terms of all the problems facing the tourism industry today where you would rate the insurance problem, if you will, in the scheme of things?

Mr. HONERKAMP. I think it rates very near the top of their concern list at the moment because it does affect everyone across the board, and it affects them in a very personal way.

We are not a State of large corporate tourism interests. These tend to be family businesses, small businessmen; and when it affects their business, it affects their family.

Mr. SCHIEFFER. These things are impossible to quantify in any kind of empirical way, but could you give an estimation of the economic impact this is having on the tourism industry in either terms of business closures or price increases where they are pricing out of the market or decline in receipts for particular industries?

Mr. HONERKAMP. I don't believe I can quantify any of those, and indeed, many of those are yet to be seen as we approach 1986 business with our increased 1986 operating level.

Mr. SCHIEFFER. One final thing, and I may draw on the expertise of Mr. Jensen on the panel here. You had made two interesting comments, one on limiting the amount of the liability, the amount of the damage award, and that issue has been discussed at some length this morning already. But you also made a comment on limiting access on who can be sued and how the claims should be filed, and in particular stating that the claim should be much more focused than many are today, in an attempt to avoid a fishing expedition, I believe.

I might direct this question at Mr. Jensen for a response. Is there a way to do that, really, without impairing plaintiffs 'rights? Maybe you can comment, too, on the extent to which fishing expeditions do exist today.

Mr. JENSEN. Well, let me say this. If you are a plaintiff, if you are somebody that has been hurt and you want to win your lawsuit and you want to get compensated and you go to a good lawyer, that good lawyer is going to figure out before he ever gets started what his theory is. You are taught early on, you have one theory and you limit your case to as few people and as few theories and as few facts as you need, because it's the plaintiff—the plaintiff wins

when his case is streamlined and goes after the person that should be gone after.

People in this State don't take kindly if you sue the wrong people. Lawyers aren't dummies. They aren't going to sue people that aren't responsible in some manner. They aren't going to get paid and juries aren't going to believe them, which is not to say that that doesn't happen.

I don't think it's prevalent practice because I don't think you make any money doing it. The injured party doesn't make any money doing it. Insurance companies aren't in the business of paying claims if their people didn't do anything wrong. Jurors aren't in the habit of giving money against people if they don't think they did anything wrong.

Mr. SCHIEFFER. But this brings to mind one study where one of the conclusions was that discovery power of the American lawyer is much greater than is the case in European countries, Japan, and so forth. They reached the conclusion that because of these broad discovery powers for American trial lawyers, that indeed there are cases where frivolous suits are brought without an intention of really winning the suit, but just to harass a corporation into settlement.

There is—and that again is something that, empirically, you cannot quantify. People would be going to jail, obviously, and this is probably another case where South Dakota—to the extent that it exists at all, if it exists—agree that it is not happening in South Dakota, and another case where South Dakota could possibly be paying for the sins of other States.

Could you comment on the extent to which you think that happens outside of South Dakota, or have you run into that?

Mr. JENSEN. I don't think it happens very often in South Dakota, and as to whether it happens outside of South Dakota, I couldn't tell you except to tell you that the law business, like any other business, has good apples and bad apples. And I'm sure there are lawsuits that are filed that shouldn't be filed.

But as to the specifics, you know, it's hard for me to address them. I can tell you that I'm sure most States have laws like South Dakota, rule 11 in the rules of procedures that you are—if a lawyer signs his name to a pleading, he should have a good faith basis for doing that. And if he doesn't, then he is liable.

If you are doing that, you are doing your clients a disservice and you are not going to get paid.

Mr. SCHIEFFER. I guess I should make clear the purpose of that question. What we are trying to get at is if there is a way, and maybe through the discovery procedure—it is—or could put some truth into that rule, the rule you just referred to needing a good faith basis, but some way to require focusing the claims.

You are saying that a good trial lawyer will focus a claim. Maybe this is a new question: one, to the extent to which claims are not focused; and two, for those that are not, how can we get at them and require them to be focused, whether that is through the rules of evidence or some kind of statute? I don't know. That is where I am drawing on your expertise.

Mr. JENSEN. I think the system is already in place; whether or not it is being used to everybody's satisfaction, I don't know. I hear

people talking about frivolous lawsuits and I hear people talking about lawsuits where the wrong people are sued, but everybody who has testified here this morning has said well, no, I am not aware of those types of cases in South Dakota.

We have had admirable claims experience; now our insurance rates are going up despite our claims experience. Yes, in South Dakota the juries are moderate. Yes, the lawsuits in South Dakota are fine.

So it's very easy to say that verdicts are out of control. It's easy to say lawyers sign pleadings—sign pleadings when they shouldn't, but not anyone this morning has said that's been a problem for them.

Mr. SCHIEFFER. With that comment, I guess we better draw another panel. Thank you very much, Bill. We appreciate it.

The next panel is Mr. Dale Yeoman from Kluthe & Lane Insurance Agency, Rapid City, and Mr. Chris Schmid, president of the South Dakota Independent Insurance Agents and president of Schmid Insurance in Rapid City.

STATEMENT OF DALE C. YEOMAN, PROFESSIONAL ACCOUNTS MANAGER, KLUTHE & LANE INSURANCE AGENCY, RAPID CITY, SD

Mr. YEOMAN. I have prepared a written statement, but the letter I received this morning—that was mailed the 19th—said I had to have 25 copies of it, and I am not prepared with 25 copies. I will just read the statement first and try and answer questions afterward.

I have been in this business 35 years and I have tried to be a student of this business. The last 8 years I have been largely engaged as a specialist handling professional liability for architects and engineers, physicians, surgeons, attorneys, realtors, and others. My thoughts and opinions, therefore, will be influenced by this background. This division of the market is usually the first to feel market restrictions and the last to feel the softening of the market.

The market for architects 'and engineers '"errors and omissions" insurance, midway through 1984, had expanded to about 15 companies. A year and a half later this market has shrunk to where you could count them on one hand. My principal market for this class is committed to providing for their present clientele, but have placed restrictions on new business.

On December 26, 1985 we received a letter from St. Paul Fire and Marine, our market for insuring medical professionals, announcing a moratorium on any new business for the present. Both companies have a large share of their special market, and it is easy to understand their position. In the face of sharply escalating claims and falling interest rates, companies become very cautious about accepting new business in these classes.

The question before all of us and your committee is what has caused these sharply increasing rates and restricted insurance markets.

In my opinion, the first and leading cause was the unrestrained competition and de facto deregulation. The breaking point was 1979, when the companies started cash-flow underwriting. Interest

rates had skyrocketed and the management of the companies seeking to capture a share of the insurance dollar sharply cut premiums and liberalized coverages. The premium then was invested at unrealistic interest rates. For a short time, it worked; rates kept dropping and the public and agents joined in seeking the cheapest rate possible. Some purchased their coverage at rates which were as low as 17 percent of the accepted standards of 1977 and 1978. Then the losses came home to haunt these cash-flow underwriters; interest rates fell sharply, and it did not take a prophet to predict what was coming. Rates had to be restored and the client who purchased his insurance at 17 percent of the standard will eventually pay almost six times more when the norm is reinstated.

In a period of 2 years, many companies have become seriously impaired and some have gone under, forced into liquidation by State insurance departments. We have now heard from those who sat quietly by during this period of rate suicide. The primary scope of regulators is to protect the consumer from excessive rates, so they chose to be very quiet while the public benefited from these rate wars. It would have been no different had it been Federal regulation. While we had no legislative mandate for deregulation, we did have a deregulation of rates, and found our industry in crisis.

My second point as to why we are in this tight market is judicial interpretation and legal extravagance. An insurance policy is a legal contract and, largely, a unilateral contract usually interpreted by law against the one who drew the contract. But we find the courts bending the contract years later, forcing large claim payments on the insurance companies. These costs were not anticipated, nor can they be recovered. These decisions have forced the insurance companies to write absolute total exclusion of some hazards into their insurance policies, leaving many cities, counties, and businesses with no coverage.

As to legal extravagance, we have had a mushrooming of legal rights and attorneys to defend these rights. Today, I may have tenfold the rights I had when I went off to defend those rights in World War II. Frankly, the insurance industry has not been able to cope with the congressionally mandated obligations resulting from these rights that have been piled onto local government and business. In our community, we have seen a 235-percent increase in attorneys listed in the yellow pages in the last 25 years. These attorneys are not the main cause of increased rates, although they may contribute in their zeal, but they are fast becoming one of the victims. What many attorneys fail to recognize is that they are a business and like any other business, when their actions require it, the public will demand that they, too, be regulated.

The joint tort feasor action seeking the deepest pocket or biggest insurance policy of business or government is an ill that we cannot much longer tolerate. The contingent fee system has been abused by some attorneys and needs some controls.

There are no penalties on the plaintiff who brings a suit and fails; the defendant must bear the personal and economic burdens of defending himself, with little hope of recovery from the plaintiff.

Today we have a society that is acclimated to a legal lottery system. This summer, a local television announcer interviewed a boy about 14 years old, in line for a carnival thrill ride. I will para-

phrase their conversation. The announcer said, are you afraid of this? And the boy replied, no, but if I get hurt, I will sue them for everything they have.

The third factor affecting availability of liability insurance—and all insurance—is our market share. South Dakota just cannot command a great deal of attention from most of the larger companies. In not one class of insurance do we write enough of the premium to be a factor, nor do we generate enough units of risk or premium to stand on our own statewide. For example, we only have enough premium on personal auto coverage to represent 0.22 percent of the total for the Nation, or slightly over one-fifth of 1 percent of the total.

For that reason, we are dependent on data from across the Nation to establish our rates and reinsure the coverage required by our businesses and governmental units. Since we must look to Chicago, New York, and London markets for reinsurance, we will pay part of these million dollar awards.

For those who agree with Ralph Nader, who says there is no crisis, let them talk to the Rapid City roofing contractor who cannot find insurance, or the client who paid a tenfold increase on his directors' and officers' liability coverage.

There is no easy answer to this problem. It took almost 5 years of foolish rates to focus attention on the problems of this industry, and it won't be solved overnight.

[The prepared statement of Mr. Yeoman follows:]

INSURANCE

Kluthe & Lane Insurance

December 30, 1985

Honorable Senator Larry Pressler
Senate Small Business Committee
Alex Johnson Hotel
Rapid City, SD 57701

Re: Liability Insurance - Availability and Costs

Senator Pressler,

Since I completed my thirty-fifth year in this business last October, have tried to be a student of this business, and because I have devoted my good efforts to our trade associations, the Independent Insurance Agents of South Dakota and the Rapid City Insurance Association, I feel qualified to speak on this situation.

My last eight years have been largely as a specialist handling professional liability for architects, engineers, physicians, surgeons, attorneys, realtors, and others. My thoughts and opinions will therefore be influenced by this background. This division of the market is usually the first to feel the market restrictions and the last to feel the softening of the market. The markets for architects and engineers errors and omissions insurance midway through 1984 had expanded to about fifteen companies. A year and one half later, this market has shrunk to where you could count them on one hand. My principal market for this class is committed to providing for their present clientele, but have placed restrictions on new business. On December 26, 1985 we received a letter from the St. Paul Fire and Marine, our market for insuring medical professionals, announcing a moratorium on any new business for the present. Both companies have a large share of their special market and it is easy to understand their position. In the face of sharply escalating claims and falling interest rates, companies become very cautious about accepting new business in these classes.

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The third factor affecting availability of liability insurance, and all insurance, is our market share. South Dakota just cannot command a great deal of attention from most of the larger companies. In not one class of insurance do we write enough of the premium to be a factor, nor do we generate enough units of risk or premium to stand on our own statewide. For example, we only have enough premium on personal auto coverage to represent .22% of the total for the nation, or slightly over 1/5 of 1% of the total. For that reason, we are dependent on data from across the nation to establish our rates and reinsure the coverage required by our businesses and governmental units. Since we must look to Chicago, New York, and London markets for reinsurance, we will pay part of these million dollar awards.

For those who agree with Ralph Nader, who says there is no crisis, let them talk to the Rapid City roofing contractor who cannot find insurance, or the client who paid a tenfold increase on his Director's and Officer's Liability coverage. There is no easy answer to this problem. It took almost five years of foolish rates to focus attention on the problems of this industry, and it won't be solved overnight.

Respectfully,

Dale C. Yeoman
Professional Accounts Manager

Mr. SCHIEFFER. Chris, why don't you go ahead?

STATEMENT OF CHRIS SCHMID, PRESIDENT, SCHMID INSURANCE, RAPID CITY, SD

Mr. SCHMID. I just have a few remarks concerning some of the things that have been said this morning.

I would like to point out that one of the basic principles in insurance is that the risk be spread, and it's true that South Dakota has got a pretty good record; but we have to be considered as part of the overall country's rates. We want to be players in the world markets, and so I think our risk has got to be spread throughout the world market and we have to come into conformity with legal systems in Europe and Japan because we have to do business there. We have to meet somewhere in between.

I have a comment on punitive damages. The purpose behind punitive damages is to punish the wrongdoer. If, in fact, an insurance company has to pay for the punitive damages, is anybody being punished? And where punitive damages are awarded, why do they go to the injured party? Hasn't he already been compensated? Shouldn't they go to make the Government—or to some charity? Or maybe punitive damages should be a criminal question instead of a civil question.

There are cases where there is some bodily injury involved but the case is taken because the potential punitive damages make it more attractive in the long run.

That's the end of my comments.

Mr. SCHIEFFER. I don't know if everybody heard back there. Don wants to make a remark on punitive damages. If you want to come up to the front, Don.

Mr. SHULTZ. I think I can speak loud enough for everybody here.

Punitive damages in South Dakota—we have never had a court decision which says punitive damages are covered under the insurance policy. Our advice usually is they are not covered under the insurance policy. An intentional act is excluded from the insurance policy. Now, as I understand it, most carriers are specifically excluding punitive damages.

So I hate to see our focus get off here on the punitive damages question when there is a so-much-bigger issue and problem to be resolved. I don't believe that punitive damages should even be addressed concerning insurance because most policies don't cover insurance unless you are buying a policy for slander or libel; then you want punitive damages coverage, but that is not the problem with small businessmen.

Our problem is really not punitive damages. Our problem is not to act like people in Japan. I spent 16 months over in Japan; I can tell you that you would not want to live in Japan and be restricted to the rights of those people, or to live in England or European countries, which are brought up under monarchies.

Those people still believe that the king can do no wrong and that they don't have rights. They have a class system. We don't live in a class system. I think to get off on those tangents really doesn't further the interest of the small businessmen that we're talking about today.

Mr. YEOMAN. I would concur.

Mr. SCHIEFFER. Can I ask a question? Does that apply outside of South Dakota, that punitive damages are covered in cases?

Mr. SHULTZ. I think punitive damages—different State courts have ruled different ways. Some courts have said they are within the coverage. Some States have held that they are not. If I had to bet, just making a guess, I would say our court would say they are probably not covered.

But the simple answer to that is put in the policy. Punitive damages are excluded. I don't think anybody can afford to pay the premium for punitive damages, or that it's really a problem for the small businessman. I don't think punitive damages are the problem for small businessmen.

You are talking about an intentional act. They have to prove that I committed a fraud on that person. If they can prove that my insurance company shouldn't have to pay for that, I should have to pay for that.

Mr. SCHIEFFER. Would it be fair to say you would support some kind of provision, whether it be State or Federal, to allow—the comment was made earlier, I believe by Dale, that some of the contract interpretations, maybe outside of South Dakota—if an indemnification clause is put in the insurance contract protecting against punitive damages awards, some courts—I don't know if that 'the indication or not, but the contract interpretation issue is a good one and this would seem to apply.

If indeed the courts in those other States would say, well, regardless of what it says in the contract we are going to require the insurance company to pay for punitive damages because the defendant does not have the ability to cover it or whatever the case may be—would you support legislation or interpretation, either on a State or Federal level, to allow contract clause indemnification against punitive damages?

Mr. SHULTZ. My theory is that I would let the marketplace take care of the punitive damages; and if the insurance company offers the policy that says punitive damages are not covered unless you pay a premium. You say no, I want to buy a policy that covers punitive damages; then I think the insurance agency could say, maybe, I could buy it for you but it's going to be very, very expensive. Do you want it?

Mr. SCHIEFFER. What about the courts outside of South Dakota that say regardless of this indemnification clause in here with punitive damages, we are going to require you to pay it?

Mr. SHULTZ. Usually it is the other way around. My experience—the reading I have done on punitive damages is that the court will say even though the policy says punitive damages are covered we are not going to force it because it's against public policy to make the insurance company pay.

As Chris pointed out, for something that the individual fraudulently did or maliciously did, that is against public policy to allow that individual to be covered by insurance, to be reimbursed by his insurance policy.

Mr. SCHIEFFER. I see a few hands, and this is going to get into an open-floor discussion. Maybe that would be a good idea. Go ahead first, Mr. Schmid.

Mr. SCHMID. I'm not advocating that we live under the system they do in England or France. I am saying we have to mingle with that system. We have to do business with the people that work under that system, and I think our system needs to be changed and their system needs to be changed.

As far as punitive damages, they tried that in the middle seventies and we went to our customers with, will you sign this exclusion so you are aware that there is no coverage? And they wouldn't sign it because they could go down the street and buy insurance from somebody else that would not require them to sign that.

So I don't think the market place would stand for it in 1975 and I'm not sure they will stand for it now.

Mr. SCHIEFFER. OK. At the risk of opening this up to the floor, I want to make sure that everyone is identified for the record.

First, I see Ray Woodsend who testified earlier has a comment on this issue, and we will call on him in just a second. Before I do, I see that we also have a couple of notes from others who would like to testify, and they will certainly be given the opportunity just as soon as we are through with this panel.

I am hopeful the Senator will be back in a couple minutes, so we are going to keep this going as long as we can. But, Ray, go ahead.

Mr. WOODSEND. I think from the area of small cities and from small businesses, the issue of punitive damages, I think, is not a major issue. But I think it's still and issue and has to be dealt with because providing defense is still a problem.

You are talking about a small town in South Dakota or a small business, if they get sued, quite often the attorney does allege maliciousness and seeks the punitive damages and they can't afford the defense costs alone. So I don't think the answer is to say we are going to let the insurance company exclude and mandate that they at least provide the defense.

Mr. SCHIEFFER. That's a good point, and I might follow up on that and ask a question of Mr. Yeoman and Mr. Schmid.

We have heard in Washington hearings—and to an extent, last week in Sioux Falls—insurance companies saying that regardless of South Dakota's situation, where currently we do not have a big problem—and let's use punitive damages as an example. There is not a major problem, but because of the uncertainties in the civil justice system from State to State and the tremendous change, especially in the products liability area, the tremendous revolution—or evolution, if you will—in the products liability area in the last 10 years, has caused so much uncertainty, there may never be a punitive damages award.

There may never be an award in excess of $250,000, but there is always that chance out there that that $5 million claim is on the horizon, and because of that we have a tough time.

We cannot actually set rates. To what extent is that a problem with your company, and to what extent do you think that exists on a national scale?

Mr. YEOMAN. I think it's a tremendous problem. That's the point I tried to make when I said we write one-fifth of 1 percent of the total automobile business in the State. You just don't have a large enough base to establish a rate. Just a year ago I was writing professional liability policies for several of the gentlemen in this room,

and lawyers. I had 250 of them. Today I have about six left. Why? Market.

The company I represented said that they did not have a sound actuarial base to allow a regional discount, so they were going to charge the nationwide rate that they had determined from their experience in South Dakota. It turned out I was outpriced by about four times. I couldn't honestly recommend to those men that they pay me four times more for a product that they could buy from a substantial company at a very good rate, and a very broad policy.

Now, that company that I represent may turn out to be right. The other company has already increased their rates once. They have restricted their amount of coverage that they are going to allow. Maybe they will join the crowd eventually; maybe I will be back in the business. But whereas I worked 4 years to get 250 lawyers on the books, they wrote—one law firm in Houston in 15 minutes wrote one with 274 lawyers.

So we don't represent much of the marketplace. When it comes to ski lifts—how many have we got in this State? Two. Shall we establish a rate for them all by themselves? They might be happy with $95,000 when it was over with.

If you want to go into medical malpractice, they brought the figure up that it's $5.5 million. What does that represent of the total medical malpractice portion in the United States? It's 0.18 and one-third percent; 118, slightly over one-fifth or slightly under one-fifth of 1 percent.

You can't establish rates on that basis. You are going to have to pay what the reinsurance market charges, and that reinsurance market is not here in South Dakota. It's in Chicago. It's in New York and it's in London and we can't live without the insurance market in London.

We just can't exist in providing the limits of liability that are required today. I started out in 1960 pushing lawyers to get professional liability. I wrote a $100,000/$300,000 policy at that time, with a grand total premium of $37 a year.

Today, if Don were to buy that policy, that same limit of liability, a $100,000/$300,000 limit from the company that I mentioned before that I had all those lawyers with would be $1,900 a year. I sure wish they would buy it at that rate.

When you get into some of these other things, you talk about how we have deregulated everything in this country in the last few years and we have created new problems that have kind of tipped the ship and rolled things around.

I heard on the TV this morning—they were talking about trucking accidents and whether trucks should have front wheel brakes or not, and so forth, and they made the statement that since 1983, when deregulation started, truck accidents have increased 18 percent. These things you can't correct with insurance rates overnight. It takes a while to get them into the system, find out about them, and work it out. It's a slow, slow process. It's so damned slow that I have been at it for 35 years and haven't learned too much yet.

Mr. SCHIEFFER. To pick up on a point that Don had mentioned earlier, and tying that in with your opening statement, Dale, that comment about—I think you were referring to almost regulating lawyers to the extent of contingent fees, punishment for frivolous

suits—that would be against the plaintiff—and that could certainly be done.

Don made an interesting point that we have seen and we have compared this morning the systems in Europe and Japan, and maybe it is true; you do not have the amount of litigation in Europe and Japan that you do here, and there is some good and bad in each system. But in Europe, for example, I know if you bring a suit and you do not win, in many cases you have to pay; the plaintiff has to pay for both defense and his own attorney fees.

Senator Pressler referred to earlier on contingent fees being outlawed in most cases, and that certainly is a deterrent to bringing many suits. But you end up with a policy question, as Don referred to, whether we want that kind of a system.

However, should we go in that area in going toward whether it be elimination or disclosure or limitation on contingent fees? And what kind of sanctions or punishment would you propose for the frivolous suit, for the plaintiff bringing a frivolous suit without infringing drastically on individual rights of plaintiffs?

Mr. YEOMAN. Well, I think I understand the purpose and reason for a contingency fee, and I have no argument with it. There are little people in this country that are walked over; and whereas it's been stated we don't have a class system, it's a class system when it comes to being able to afford a lawyer, I'll tell you that, and a contingency fee should be available to the public that can afford it.

However, I do feel that it does give rise to abuse by some lawyers. In any class of society you want to look at, or any occupation, you have the good, the bad, and the indifferent. And I don't think the bar association has been 100 percent successful in policing their ranks any more than the insurance agents may have been in policing their own.

In fact, we don't even have the weapons to do it, but they do and I do feel that you would only have to do one thing; and you would say this: Mr. Lawyer, you take this lawsuit on a contingency fee basis all the way. You pay the bill. You pay the cost of discovery, and so forth; and if you lose the case, you pay the defense costs of the plaintiff—or of the defendant. And it would sharply reduce the amount of claims that would be handled, and I still don't think it would harm the contingency fee system.

There would be a lot of people that wouldn't go to court, yes, but sometimes we have to reach a level of denying somebody some rights. We can't keep expanding and expanding.

I don't see how we can afford it, and when you get into the joint tort feasor—you take the hospital up here; they want to require a doctor to produce evidence of insurance before he can practice there. They are running into a small revolution. There are some doctors that don't think they should have to buy insurance to practice there. All right; if you allow the doctor to practice in the hospital without insurance, the hospital ends up in a lawsuit and the doctor ends up in a lawsuit.

The doctor has no assets that they can acquire. He has been smart enough to put them all in his wife's name, and it turns out the hospital is 2 percent at fault and the doctor is 98 percent at fault. The hospital pays the whole bill.

Now, where is the fairness of this system? I'm not asking for anything that is unfair. I am just saying that I think we have to really examine some of the values that we have established and which the public now looks at as being fair game. All they are interested in is the deepest pocket and the biggest insurance policy.

I would like to offer one other thing. I turned around and saw a fellow back here, that I write his professional liability. Just a couple weeks ago we paid $200,000 to buy a claim because the estimated cost of taking it to court after 4½ years of fooling around with it was $700,000 for the court trial. So we bought the claim for $200,000. We didn't feel we owed it, but we made $500,000 on the deal. We feel these things are a little unrealistic. We spent a lot of time on the civil justice.

Let's go back and look at cash flow underwriting practices and so forth, and that is where insurance companies are underpricing the policy in terms of the claims paid versus premiums in order to acquire funds to invest into the markets—and they were able to do that because of the high interest rates and high yield returns.

The insurance companies are criticized for that quite severely right now. Should it be—the question is, I guess, how wrong is that? Would it have been correct for the insurance companies not to subsidize, in effect, the insurance rates because of the high yield they were receiving from their investments during the late seventies and eighties, rather than them, in effect, passing on—the insurance companies will say, sure, we underpriced the policies because we were passing on the savings to the consumers. If they had—their argument is if they had gone ahead and charged full price based on the claims incurred, then there would have been an uproar.

Let's go back to 1950, when I went into this business. It was sacrilegious at that time to even consider investment income in an insurance company's overall schedule in determining rates, and during that period of time since it has now been thrown all together; and you look at what the insurance company is getting as a return on its dollar. I'm not saying that insurance companies charged excessive rates in the past; they were well regulated. There was very little competition. You could go down the street and get 15 agents to quote you the same identical policy, and they would all quote you the same rate. This went on for years, but now Chris' granddad was in the business and he represented a mutual company, and they sold it for 15 percent less. But they sold one class of clients; we sold another.

And then after everybody got to cutting—and it really started in 1979, the cash flow underwriting—and it is the fault of the companies. They have nobody else to blame for it. They are the ones that determined the rates were going to go down, and it was kind of foolish.

One office of the Fireman's Fund would cut rates; another office wouldn't, but they all bent and bowed and they all went down together. And another result of this is that we have had companies, such as Glacier up in Montana, that went broke this last year who were really hornswoggled by a broker and some employees of the Bank of America for about a $120 million loss.

That company went under as a result of that. It is interesting to note that there were some policies written in South Dakota with that company. It was classified by A.M. Best Co., as an "A" company, very substantial, just 2 years prior; and bang, it went down.

Now, the problem created is not only that that company goes broke, but they issued a group of current coverage policies for professionals. A lot of medical professionals, a lot of clinics, specialty clinics, and that leaves a blank on that coverage back there. If you purchased your coverage in 1978 and 1979 from that company and it went broke and a claim arises out of that 1978–79 period, that client is sitting there without any coverage for that period of time.

There is a group of doctors in a clinic here in Rapid City that have purchased coverage from that company for a considerable period of time who would give their left arm, their right leg, and probably several hundred thousand dollars to buy a policy that would go back and cover over that period of time. And they are faced with a good sized claim right now that they are going to have to pay out of their own pocket.

The other backlash of that is this. That same group of people that were insured with that company come into the marketplace and want to be insured, and that just adds to this capacity crunch that we've got.

We can't get away from it, and as I mentioned, we had 15 companies writing architects and engineers. Now we are down to five, or four, maybe. What do we do with those clients that come from those other 10 companies? Where do we put them?

When my company says, hey, we've got enough right now; let's get our breath and see if we can recover first—and so if you don't think we have a crisis, you are just fooling yourself.

Now, I heard some question with regard to the investment quality, and we're talking about that, number one. Hey, I don't think there is any problem with the investment quality of any of those insurance companies. They hired the best brains in the country, and you ought to see the returns they have gotten. In fact, the very same person who questioned the investment quality here today, then turned around and mentioned how much money the insurance companies had made off those investments and how much this should cut into those rates. There is a rather conflicting statement there. I think the investment quality has been good.

We have a rule in this industry—right or wrong, I guess; it's an old one, and I don't know what validity it has—but it says if you have 1 million dollars' worth of policyholders' surplus, you can write 3 million dollars' worth of business. Well, that might be very good over the average, but in other areas it probably should be expanded to five or six. And maybe in some other areas it should be cut back to two or one. But to just say it's 3 to 1 and judge every company on that basis is a little bit faulty and this is where we run into trouble with State regulation.

A State regulator looks at it and says 3 to 1, that's it. You exceed that and you're in trouble and it takes a lot of help. In South Dakota we will collect about $19 million in premium taxes this year, maybe even larger than that with the way these rates have gone up, and I think we are going to spend about $500,000 on the regulation process.

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Are we getting what the public is paying for? I don't think we are. We don't have the smarts up at Pierre to stand up to a $500,000 a year insurance executive and tell him he's doing it wrong, when we pay our insurance department head about 30 grand a year.

Mr. SCHMID. I would like to make a comment on your original question, Kevin. It was mentioned in 1979 the rates started going down, and they kept going down until about 1983. And a typical case was if we had a nice $10,000 account in 1979, if we still had it—if we survived the competition—it was now a nice $5,000 account.

So we reduced that by 50 percent. What we are doing in 1984 and 1985 is doubling the rates. They are back up to where they should have been, except for the effects of inflation.

So the things we are paying for, fenders and medical bills and roofs, have gone up and we have kept it level with this rate increase.

Senator PRESSLER. Well, I thank you. I apologize again for my absence.

And let me ask each of you—let me assure you I am going to read every word of the testimony because I think this is very critical, your portion of it.

If this has been covered before, stop me. First of all, there are two pieces of legislation in the Congress that are alive. One is Senator Kasten's and my bill on uniform level of product liability, which would be a first step of the Federal Government setting a uniform standard across the country.

The second bill is Senator Hatch's, which in the first instance would not apply to medical punitive damages but would set a $250,000 punitive damage limit. And these two bills are in the Senate—ironically enough, sponsored by the persons who are usually against Federal intervention, New Federalism and States' rights and so forth—and they would be a basic departure from the McCarran-Ferguson Act of 1945.

If you have not done so, would you comment on these two pieces of legislation? And if you would like to respond more in writing, you may do that.

Mr. YEOMAN. Well, I address the punitive damages situation. I am of the opinion that punitive damages should not be insured. I would go to amend your bill and bar any coverage for punitive damages, period. I think that the person that is penalized ought to have to pay the penalty. I just don't see insuring it, and I agree with Don Shultz back here, who made some remarks on that while you were gone, Senator, which were very good.

I think that in the area of uniform product liability I would not want to address any opinion until I had read what you have manufactured, but we do need some uniformity, and we do need some help in that area. And you ought to try to buy product liability; in South Dakota for a new business, especially for a totally new enterprise, one that is manufacturing a total new product that is an entry into the market.

People from South Dakota just aren't supposed to come up with these kinds of things, and it makes it very hard for us as insurance people to obtain coverage for these people.

Senator PRESSLER. That is certainly true. One company that testified in Sioux Falls indicated they had close to 40 percent of the cost of their product was insurance, and that means we are losing jobs, and so forth.

But you introduced an interesting point from an intellectual point of view, at least realistically, that punitive damages are supposed to punish somebody for carelessly or negligently doing something wrong.

Once you have him completely insured against punitive damages, if he is operating or whatever else, he is really free of any punitive damages. So your point is, if we didn't insure punitive damages, people who really—and if it was known that people are not insured for punitive damages—I think now a jury of laymen think, this guy no doubt has insurance. That is not allowed to be said, whether he does or doesn't, but they assume the doctor has insurance. It's not costing him anything. We might as well give him $5 million.

So I guess my question boils down to, I think your first point—if we made punitive damages smaller, or maybe juries would make them smaller, but once you have insured punitive damages, then punitives have lost all their force; is that correct?

Mr. YEOMAN. I would agree it loses its force of penalizing the person if he was insured, and most medical malpractice policies do not have an exclusion against punitive damages.

One of the side effects of this rate cutting was to liberalize coverage. We liberalized it in order to attract that dollar, to get it into that cash flow market and to invest it. And now we have liberalized these policies so much, and now we are cutting them back.

Ray Woodsend made a comment with regards to landfill operations. You ought to see the exclusions that are written on pollution, asbestos, and some of these things today. You won't have any trouble interpreting those in court; 14 ways say no coverage, and then they make the client sign it. And so, the insurance company is through being taken for a judicial interpretation right on that one, and sanitary landfills, lagoon systems, so on and so forth.

These are all going to be excluded and I don't know where they are going to find coverage for them. And I don't know who is going to provide for taking care of that waste. Maybe this will be as much of a problem as low nuclear waste.

Senator PRESSLER. Well, I thank you. From the notes here, you have covered many of my questions that I had planned to ask; and as I understand it, we have in the audience the mayors of Hot Springs, Carl Oberlitner, and Belle Fourche, Chuck Snoozy in the audience, and it is a tradition to recognize them.

Any others who wanted to make an oral statement, if they would limit it to 2 minutes. We have three people who have made a special request, and if they would be kind enough to limit it to 2 minutes and we will put the written statement in the record.

Bob Helmer, Larry Reinhold of Rainbow Bible Ranch and Jim Bell, if they would come forward.

First of all, I want to thank you very much. I will read what you wrote very carefully. And let me say your partner who is now deceased, Mr. Kluthe, was a good friend of mine and I think you represent the best in the industry, and I thank you very much, both of you.

Can we have those three witnesses come forward? We will hear from anybody else who wants to make a written statement. It will be taken into consideration.

Mr. HELMER. I yield my time to these two gentlemen and give them 3 minutes apiece.

Senator PRESSLER. Who wants to begin? Identify yourself and go ahead.

STATEMENT OF JAMES G. BELL, EXECUTIVE DIRECTOR, CONSULTING ENGINEERS COUNCIL OF SOUTH DAKOTA

Mr. BELL. My name is Jim Bell. I am speaking as the executive director of the Consulting Engineers Council of South Dakota. All of our member firms are small businesses. I have been a registered professional engineer since 1953 and have also been in the business of consulting engineering during this entire period.

A survey of 13 architecture and engineering firms in South Dakota for the period January through May 1985 revealed that professional liability insurance premium renewals during that period increased an average of slightly over 100 percent.

The picture has only worsened in the past 7 months, and looks even bleaker for the coming year. Communications I receive from engineering organizations across the Nation indicate that those firms which can still find insurance coverage are facing premium increases approaching 300 percent.

In addition to that, as previously pointed out, many exceptions and exclusions are now contained in policies concerning design of facilities, involving not only asbestos and removal of hazardous wastes, but also waste treatment facilities for municipalities.

These grim facts translate into astronomical financial burden for all professionals and most companies, especially the small ones, and there is little relief in sight.

Many insurance underwriters are scrambling to get out of the business of covering small clients altogether. Because of the unavailability of reasonable insurance coverage, many small businesses have been forced to close down or go bare. Going bare means a business chooses to operate without any insurance coverage, with bankruptcy as its only choice if it is eventually hit with a lawsuit.

Unfortunately, in the case of a professional engineering firm, those professionals may be liable as individuals.

Another hidden factor besides the terrific costs to the consulting engineers and architects of this State for the increased premiums which normally would be passed along to the client is the fact that we have had a sluggish economy for several years in South Dakota. Most of the firms have been forced to absorb this cost, but most firms have now reached saturation point in absorbing those insurance premiums, which frequently require all of the firm's annual retained earnings being paid for the insurer's premiums.

Another hidden but real cost to the client is the cost resulting from overdesign. In an attempt to protect himself against potential lawsuits, an architect or engineer may be inclined to design a project in the most traditional noninnovative fashion, using overly conservative design criteria. This practice not only increases the cost to the owner, who is totally unaware of the excessive costs he

may bear, but also stifles the use of new, innovative techniques and new materials. America can ill afford to stop the clock in design techniques and development of new materials and construction techniques.

Well, how did we get into this mess? One key factor lies in recent legal movements by activist judges and civil lawyers who see no bounds of their market of ever increasing bounds of civil liability.

I have covered a number of other points in here, Senator, but I will bypass them in the interest of time. I would like to point out, though, the fact that nuisance lawsuits, those filed without basis and with no hope of winning in a court of law, are on the increase.

A professional engineer or architect has absolutely nothing to sell except his time and talent. Nuisance lawsuits are devastating to the professional's psyche and income. It literally can destroy his ability to accomplish creative and accurate designs.

Furthermore, preparation for, participation in, and gathering up of a professional's reputation after a long court case can—and very often does—destroy the professional's livelihood.

Therefore, most of these claims do not go to court because it is less costly to settle them out of court than to pay for defense. In these cases a nondeserving plaintiff and his lawyer get money from an innocent defendant.

I have personal knowledge involving a South Dakota engineering firm wherein the plaintiff, after 2 years of legal wrangling, offered to settle the action for the exact dollar value of the engineer's professional liability insurance coverage, less than one-half of the amount of the original claim. And we ask, is this justice or extortion?

This professional business group does not presume to write the legislative language required to stop this rape of justice, but we do have strong feelings concerning some ingredients necessary to achieve a proper end result.

We would suggest that there be some type of maximum limit on damage awards, particularly for punitive and noneconomic claims.

The present language regarding workman's compensation needs to be rewritten to discourage some of the inequities that result therefrom.

Contingent fees for professional services should be illegal. This entire concept fosters a something for nothing attitude on the part of potential plaintiffs and encourages members of the legal profession to prey on the hopes and dreams of the unwary and use the court system to abuse the rights of defendants.

Reform should be initiated to make it easier to recover from plaintiff and his legal counsel for costs borne by the court and by the defense in nuisance suits.

Public opinion mandates the legal profession clean up its professional activities in the qualifications of its membership, and qualifications and ethics of its trial lawyers, and method of securing fees and in the quality and integrity of candidates it proposes for consideration as judges.

Without a return to a more reasonable and equitable system of civil justice, our segment of small business private enterprise may well disappear from the scene.

Thank you very much for giving us the opportunity to make these comments.

[The prepared statement of Mr. Bell follows:]

STATEMENT PRESENTED TO: Senator Larry Pressler, Chairman
U.S. Senate Small Business Committee Hearing
Rapid City, South Dakota
December 30, 1985

BY: James G. Bell, Executive Director
Consulting Engineers Council of South Dakota

TOPIC: Increased Cost of Liability Insurance

My name is Jim Bell, and I am Executive Director of the Consulting Engineers Council of South Dakota. All of our member firms are small businesses. I have been a registered professional engineer since 1953 and have also been in the business of consulting engineering during this entire period.

A survey of 13 architecture and engineering firms in South Dakota for the period January through May, 1985, revealed that professional liability insurance premium renewals during that period increased an average of 100%. The picture has only worsened during the past 7 months and looks even bleaker for the coming year. Communications I receive from engineering organizations across the nation indicate that those firms which can still find insurance coverage are facing premium increases approaching 300%.

These grim facts translate into an astronomical financial burden for all professionals and most companies, especially small ones, and there is little relief in sight. Many insurance underwriters are scrambling to get out of the business of

covering small clients altogether, mainly because it is easier, less risky and more profitable to sell lots of insurance to a few big, stable customers. Large corporations also generate heftier premiums for less administrative work and thus wield greater leverage with underwriters than small companies.

Because of the unavailability of reasonable insurance coverage, many small businesses have been forced either to close down or "go bare". Going bare means a business chooses to operate without any insurance coverage with bankruptcy as its only choice if it is eventually hit with a lawsuit.

When insurance is available, its cost represents an enormous hidden burden normally passed on to the client. However, in South Dakota, the keen competitiveness of the professional architect-engineer service market coupled with a sluggish economy for several years has meant that the firm operating in South Dakota generally must absorb the cost. Most firms have reached a saturation point in absorbing these insurance premiums, which frequently require all of the firm's annual retained earnings.

Another hidden but very real cost to the client is the cost of over-design. In an attempt to protect himself against potential lawsuits, an architect or engineer may be inclined to design a project in the most traditional, non-innovative fashion using overly-conservative design criteria. This practice not

only increases the cost to the Owner who is totally unaware of the excessive costs he may bear, but also stifles the use of new, innovative techniques and new materials. America can ill-afford to "stop the clock" in design and the development of new materials and construction techniques.

How did we get into this mess? One key factor lies in recent legal movements by activist judges and by civil lawyers who see no bounds to their market of ever-increasing expansion of civil liability. These judges and lawyers have become dissatisfied with using civil law merely as a means to deter undesireable conduct and now want to use it as a vehicle to restructure society and administer a massive social insurance scheme.

One example is the movement toward no-fault liability. Traditionally, civil law punishes those who have done wrong by making them compensate those whom they have wronged. But, increasingly, civil law now punishes those who have done nothing wrong, simply because they often have the resources to compensate the plaintiff.

But the primary beneficiaries of expanded civil liability have not been the plaintiffs -- unless you count lawyers in that class. Attorneys' fees frequently amount to one-third to one-half of any award granted by a jury.

"Nuisance" suits -- those filed without basis and with no hope of winning in a

court of law -- are on the increase. A Professional Engineer or Architect has absolutely nothing to sell except his time and talent. Nuisance lawsuits are devastating to the professional's psyche and income. It literally can destroy his ability to accomplish creative and accurate designs. Furthermore, preparation for, participation in and gathering up of a professional's reputation after a long court case can and very often does destroy the professional's livelihood. Therefore, most of these claims do not go to court, because it is less costly to settle them out of court than to pay for defense. In these cases, an undeserving plaintiff and his lawyer get money from an innocent defendant. I have personal knowledge of a case involving a South Dakota engineering firm wherein the plaintiff, after two years of legal wrangling, offered to settle the action for the exact dollar value of the engineer's professional liability insurance coverage, less than one-half the amount of the original claim. Is this justice -- or extortion?

The trend toward liability without fault or proof of causation is based upon emotionalism and an unprincipled willingness to award recoveries against "deep pocket" defendants.

Another problem in our civil justice system is the extraordinary increase in the size of awards. The prospect of multi-million dollar awards provides a

strong incentive for individuals to sue, and it also inflates the size of initial damage claims. The most troubling aspect of this development is that much of it has come in the form of non-economic damages, such as pain and suffering or mental anguish and punitive damages.

Punitive damages were originally intended to punish particularly malicious conduct. Such damages may have a place in a system founded on fault. One would therefore expect that as the civil justice system moved away from fault, punitive damage awards would become rarer. Not so. The incidence and size of punitive awards seems to be increasing.

If this trend toward massive increases in punitive and non-economic damages continues, its impact on the economy of this nation is likely to be devastating. This devastation is already being felt by small business, and particularly professional engineers and architects, in South Dakota.

This professional business group does not presume to write the legislative language required to stop this "rape of justice", but we do have strong feelings concerning some ingredients necessary to achieve a proper end result:

1. Place a maximum limit on damage awards, particularly for punitive and non-economic claims.
2. Present language regarding workmen's compensation must be rewritten to

discourage multiple suits against other parties for damages beyond the workmen's compensation awards.

3. Contingent fees for professional services should be illegal. This entire concept fosters a "something for nothing" attitude on the part of potential plaintiffs and encourages members of the legal profession to prey on the hopes and dreams of the unwary and to use the court system to abuse the rights of defendants.

4. Reform should be initiated to make it easier to recover from plaintiff and his legal counsel for costs borne by the court and by the defendant in nuisance suits.

5. Public opinion mandates the legal profession clean up its professional activities:

   a) in the qualifications of its membership

   b) in the qualifications and ethics of its trial lawyers

   c) in its method of securing fees; and

   d) in the quality and integrity of candidates it proposes for consideration as judges.

Without a return to a more reasonable and equitable system of civil justice, our segment of small business private enterprise may well disappear from the scene.

Senator PRESSLER. Thank you for that very forthright statement.

Next, Larry Reinhold of the Rainbow Bible Ranch, and I want to thank our stenographer; we are just about through. I know your hands are tired. We are about to the end here.

STATEMENT OF LARRY REINHOLD, RAINBOW BIBLE RANCH

Mr. REINHOLD. I represent Rainbow Bible Ranch north of Rapid City, here. We are a small, interdenominational, nonprofit, private camping program, and last June we received notice from our agent that we did not have liability insurance anymore.

If you know anything about the camping program, that is right when we start. We were, however, able to get a binder to carry us through the summer, and we finally found a company that would cover us.

And I might mention that is the only company in the United States that would cover us, and our premiums went from around $600 to better than $4,500, and I guess my main concern would be we strive to keep our prices low so that it does not limit anyone from coming out.

A lot of the kids that come out would not be able to afford the higher prices. We strive to give them a good time, that they would have a profitable time both physically, mentally, and spiritually, and a lot of the people that work there work for a very minimum wage, and a lot of them are volunteers.

I guess, according to our agents—our insurance agent—he says that our insurance could go up $1,000, $2,000, who knows what, next year. I really have a lot of concerns about that. We did cancel our rodeo camp because of insurance problems last summer and all the rigamarole and added costs, and so we have already started to cut into our program.

The way it looks, this next summer we are going to have to raise our prices pretty considerably and I am afraid that we are going to start cutting out kids. And I would have to add to that, that there is some sort of a crisis going on, whatever you want to title it. We faced a crisis this past summer and it's been very trying, and I wish to thank you for the time that you put into it, too. Thank you.

Senator PRESSLER. Well, I thank you very much because I think what you have said illustrates the problem in that we are cutting back on useful activities, why it is hurting, and it's our job as legislators to try to find a solution. And I thank you both very much.

I believe this concludes our hearing. I will be here for a while. Thank you very much for turning out so well. I think this hearing has been very useful to me and I will read very carefully the portions that I missed, but this, combined with the Sioux Falls hearing, will be taken back to Washington. And in addition, I have a questionnaire in my last newsletter which we have had a terrific response to. We are tabulating those.

In addition to that, the Commerce Committee and Small Business Committee will both be holding additional hearings on specific legislation, and we have asked the insurance companies for some data which will be coming in in early February.

I want to thank those of you who have been here. I want to thank the witnesses, thank the staff and all who have worked on this. I have learned a great deal. Thank you very much.

[Whereupon, at 12:30 p.m., the hearing was recessed, to reconvene at the call of the Chair.]

APPENDIX

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CONSULTANT

November 25, 1985

The Honorable Lowell P. Weicker, Jr.
Chairman
Committee on Small Business
428A Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Weicker:

I am writing and submitting comments on behalf of the Coalition of Automotive Associations (CAA) with regard to the recent field hearing held before your Committee on the current insurance problems facing small businesses. CAA is a trade association comprised of over 2,100 manufacturers and distributors of aftermarket parts and accessories for motor vehicles. We appreciate the opportunity to submit our comments concerning this issue and respectfully request that they be made a part of the record of the aforementioned hearings.

The Association's membership is comprised of small businesses, a majority of whom have recently been experiencing declining profits as well as an increased threat of losing their businesses. This dramatic shift in revenues can be attributed primarily to the insurance crisis many manufacturers and distributors of products are experiencing, regardless of the industry in which they are engaged. Over the past several years, the price of property-casualty insurance, including product liability coverage, has skyrocketed in the United States while the availability of coverage has been significantly reduced. Our members have found that, in the past two years alone, the levels of insurance available to them have decreased from $10 million, to $5 million, to $1 million, and now, $300,000 in aggregate claim amounts. And for those members offered coverage in amounts approaching $300,000, the premiums have increased to $25,000 to $50,000 per year where they had been previously averaging $2,000 to $5,000 per year for $5 million in product liability coverage. The members who have been successful in retaining reasonable limits of liability coverage have experienced increases in premiums of 300 to 1,000 percent. Many small businesses will soon be forced to stop

carrying property-casualty insurance while others will simply be driven out of business as a result of this crisis. These parties will not be the only ones to suffer. Consumers will continue to experience substantial increases in the cost of consumer products. In addition, consumers injured by a product will find that they have no source of compensation due to the limited assets and no insurance coverage of the manufacturer, distributor or retailer of the product.

Unfortunately, the resolution to this burgeoning problem is not as clear as the present need for some sort of action to be taken. We submit these comments in the anticipation that such action will soon be taken to curb the current insurance crisis which has, and will continue to, adversely affect our members. Once again, we thank you for the opportunity to comment on this critical issue.

If we may be able to provide information regarding the above, please do not hesitate to contact our office.

Sincerely,

John Russell Deane III

JOHN RUSSELL DEANE III

JRD/sdg

Taylor Lumber & Treating, Inc.

Post Office Box 567
BEAVERTON, OREGON 97075
Area Code (503) 646-8161

December 27, 1985

The Honroable Lowell Weicker, Jr.
428 A
Russell Building
Washington, DC 20510

Dear Senator Weicker:

On October 15, 1985, I had the opportunity of presenting testimony at the Ron Wyden Hearing in Portland, Oregon.

Since you are Chairman of the small business committee I thought it would be appropriate to submit my testimony to you relative to our bonding and insurance problems.

The small business sector of our industry has gone through some difficult times and since the insurance companies are compounding our problems we would like some relief.

Thank you.

Very truly yours,

TAYLOR LUMBER & TREATING, INC.

Norman J. Siefken
President

Enclosure

NJS/lsq

STATEMENT OF NORMAN SIEFKEN, PRESIDENT, TAYLOR LUMBER & TREATING CO., BEAVERTON, OR

Mr. SIEFKEN. I thank you very much for giving me the opportunity to be here today. My name is Norman Siefken, and I am president of Taylor Lumber & Treating Co. It is a small family owned business, and it has been there over 30 years in Sheridan, OR. We employ about 200 people. And being the largest employer in the big city of Sheridan, they are very dependent on our payroll.

Of course, we are not unique. There are many, many small business mills of our type in Oregon. However, there are a lot of them that are not there today. And this, of course, has been very devastating on our communities, catastrophic to the families, and the men without jobs. So what we are really concerned about are some of the things that affect our business.

Some of the things that I would like to discuss today is the bonding and insurance rates. And since we are 90 percent dependent upon the Forest Service, and BLM, and State timber, this bonding is very, important to us.

Our bonding rates in 1980 for performance and payment bonds were at the $4 and $5 rate. As we went into our depression—everybody calls it a recession, but I call it a depression for us—the insurance companies, the bonding companies, raised our rates periodically until it came to a point where our rates were $12.75 and $15.

And we were also told that they did not really care about our business, and they would be very happy if we took it elsewhere. We did just that. We went to another company, we got our bonding changed, and the rate at that point was $9 and $10. Now in the last few months, our latest bonding company again has told us that our rates are now back up to board rates of $12.75 and $15 again.

And without bonding, we would have one heck of a time, I could use other words, of running a business. We could do it partly, but it would be tough. And I understand, and I have no proof of this, but I understand that big businesses has bonding rates that are still in the neighborhood of $2 to $4.

With what we have to pay for our timber, and now what we have to pay for our bonding, it just puts us into a crunch. And I assume that we are not the only small mill. In fact, I have heard of other mills that cannot even get bonding.

For several years, we lost money. In the last couple of years, we have been moderately successful. Our men have taken a cut to help out. We have increased our productivity, and as Joe McCracken was talking about, this helped tremendously. The local bank has been very helpful to us.

In fact, in the last month, they lowered our interest rates. It is still the bonding. The insurance companies say, hey, we do not want your business. This is what we charge. If you do not like it, go someplace else. And there are very few bonding companies that you can go to.

And another thing. If we were such a bad risk, I am speaking of our company in particular, why does the bank continually lower our interest rates. In fact, they have even offered to lend us more money.

So we have come through a tough, tough time. I think that we have been relatively successful, but still we are being bombarded by this problem.

We understand Joe McCracken of the Western Forest Industries Association, has had some discussions with some people at the Small Business Administration about our bonding problem. And as I understand it, the SBA does issue bond guarantees. However, there is a $1 million limitation and a 1 year limit on time.

Even though the amount of the Forest Service bonding has a limit of $500,000, the value of the contract usually exceeds $1 million. With the price of timber, this amount is exceeded. And the length of most contracts is 2 to 3 years. This usually was higher previously. Would or could the SBA work with the timber industry relative to our bonding problem?

If the million dollar limitation is statutory by nature, would it be possible to change this. Possibly it could be used for the bonding limitation rather than the contract value. In other words, the $500,000 limit could be used rather than the total contract value.

Mr. WYDEN. Excuse me for interrupting.

Then that would not cost the Government any more money, would it?

Mr. SIEFKEN. No. No additional cost to the Government regard to tin regard to the duration of the contract, the one year limit is too severe to our business. I do not know whether this is a statutory problem or whether it is the policy within the SBA, but whether this could be changed or not we don't know. I understand that the million dollar limit is statutory.

Mr. WYDEN. Let me just interrupt you for one second.

Has the SBA made any effort to meet with the small timber operators on this?

Mr. SIEFKEN. WFIA, Joe McCracken, has had the only contact that I know of. I have not discussed this with anybody else.

Mr. WYDEN. Because if the small operators would find it helpful, I think that I could certainly arrange for such a meeting.

Mr. SIEFKEN. I think that we could be very appreciative of that.

Mr. WYDEN. Excuse me for interrupting.

Mr. SIEFKEN. No, that is perfectly all right. So maybe there could be an easy way to change this. This is just generally an overview, and I will speed along to complete my statement. Another situation with our company is the insurance rates. At this point in time, our insurance rates, let us take an umbrella policy for instance. In 1980 for $10 million, our umbrella policy was $9250. That was our yearly cost. Then 2 years ago we increased it to $20 million and the cost was $11,000.

This year, the most they will give us, the insurance company, for umbrella coverage is $2 million primarily part of this reduction is because we own a treating plant, The cost is $20,000 for the $2 million. Previously, we had a $11,000 cost for $20 million.

Mr. WYDEN. So your insurance costs more than doubled in 1 year?

Mr. SIEFKEN. That is right, that is so right. This is just our umbrella coverage. Our property and casualty has gone up 60 percent. Our fire insurance has gone up only 10 percent, only I say. And over a 3 year period, our Workers Comp has gone between 20 and 30 percent.

So not only are we being hit by the high cost of stumpage, but we are being bombarded by the bonding people who say, hey, we really do not want you, so take your business elsewhere. And the insurance company is boosting the cost or our get the SBA to have a meeting with your people. And maybe there is one other thing that you would like to have done.

Mr. SIEFKEN. The bonding and insurance, and the amount timber that they offer. That is very important, because we rely on this. There are certain areas, and how it's distributed from area to area.

Mr. WYDEN. You would say simply increase the amount?

Mr. SIEFKEN. Yes.

Mr. WYDEN. Mr. Hampton.

Mr. HAMPTON. I would like to hear Max Peterson say to his troops I want to charge you as professionals to deliver under the multiple use in the Sustained Yield Act all of the amenities of the forest while enhancing the output of the commodities. Because it is doable, Congressman Wyden, it is doable, and it is the responsible thing to do.

Mr. WYDEN. It is what Oregonians want.

Mr. HAMPTON. And need.

Mr. WYDEN. What Oregonians want is for the timber businesses to operate and product the wood products we need and preserve the environment.

Mr. HAMPTON. It is not necessary to trade off one for the other. Those amenities can be enhanced, maintained and enhanced, while still increasing the output of the National Forest for timber.

* * * * * * *

Mr. WYDEN. And this is another routine sale?

Mr. GILES. Well, in part some of them are TEA, which is new sort of appraisal system that many people can tell you about. The others are just typical sales that the BLM has now responded to some criticism on appraisal bid ratios, so they have upped the appraisal rates and they are not selling.

Mr. WYDEN. What percentage, gentlemen, of the timber that you harvest comes from National Forest lands?

Mr. GILES. We are approximately 80 percent. The private that we buy comes from G.P., Weyerhaeuser, I.P.

Mr. WYDEN. Mr. Hampton.

Mr. HAMPTON. We harvest about 10 percent, a little less than 10 percent of our own lands. We depend on the National Forest and BLM for about 80 percent of our harvest. And it is about 50-50 BLM and Forest Service.

Mr. SIEFKEN. We are 80 or 90 percent.

Mr. WYDEN. Do all of you have enough timber under contract to keep working through the winter?

Mr. HAMPTON. Yes, we have 1 year and 4 months backlog.

Mr. GILES. We have about 1 year's worth of supply.

Mr. SIEFKEN. We are about 1 year.

Mr. WYDEN. Do you know of operators who do not have enough timber and are concerned that they cannot get it?

Mr. HAMPTON. Not in my neighborhood. I think that everybody will make it through this winter.

Mr. GILES. There are in our neighborhood, and these are potential purchasers of the BLM sales that going no bid. They have made a business decision that I will not buy for volume sake, but I am going to buy if I have profit.

Mr. HAMPTON. That is unique for us.

Mr. WYDEN. Do you think that the matters that we are talking about today like output affects our situation with Canada? We did not choose to talk about Canadian imports today for a couple of reasons. One, it is a matter of such enormity that you have to practically devote a special hearing to that, and I felt that this was a unique area that really ought to be specifically looked at. But I am curious and just for the record in terms of output and price, is this part of the equation of competing with Canada?

Mr. GILES. Very definitely, in our opinion. I think, Representative Wyden, that one of the key factors in today's wood products questions and the problems that we are dealing with is the fact that there is an oversupply of end product. And the only way that the Northwest can be competitive is to have the raw material costs, their labor component, and the transportation component in those marketplaces competitive with whoever the other producer is, whether it is the Canadians, the Southern, or wherever they come from.

Mr. HAMPTON. An abundant supply of public timber will mean less severe competition at the bidding table and a more competitive Pacific Northwest industry.

Mr. SIEFKEN. The Jones Act. Something, some day, and some way should be done about the Jones Act.

Mr. WYDEN. Another hearing another day.

Mr. SIEFKEN. I know.

Mr. WYDEN. Just for the record, we have got lots of issues that are before us. The Canadian imports, the tax bill. Many of you know that I have been involved in the capital gains issue, and the reforestation issue, interest rates, budgets.

But do you share the view of the earlier panel that forest planning, the issue with the Forest Service that we are talking about today is the number one concern of the Oregon industry?

Mr. GILES. 70 percent of our constant sales are raw materials.

Mr. SIEFKEN. A big portion of it.

Mr. HAMPTON. If you are not competitive, you cannot market in competition with the low cost producer in the interior B.C. But I think that it is important to qualify that by recognizing that we do need to emphasize marketing, and we are. We are spending the money on that.

Mr. WYDEN. Unless you have anything further, I thank you for your participation.

Mr. HAMPTON. Thank you.

Mr. SIEFKEN. Thank you very much.

Mr. GILES. Thank you.

Mr. WYDEN. And I will be getting back to you on several of those matters. Our next panel is from Western Oregon. Mike Burrill, president of Eugene F. Burrill Lumber Co. and Bill Gregory, president of Gregory Timber Resources; and Bruce Engel, president of WTD Industries; and W.M. (Whitey) Howard, vice president of Seneca Sawmill in Eugene.

Gentlemen, we welcome you, and please come forward. And excuse me, Don Johnson, timber manager, Rough and Ready Lumber Co., Cave Junction, Or. Gentlemen, in the interests of time, if you could summarize your key concerns. We have got about another hour or so. We can have about a half an hour for our two panels each. If you could all summarize your key concerns, we will have a little time for questions. And I will make a part of the record your full and prepared remarks.

Why do we not begin with you, Mr. Engel, unless you have some preferred order, and we will just go right down the line. We welcome you.

RON WYDEN
3D DISTRICT, OREGON

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Congress of the United States

HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515

COMMITTEES
ENERGY AND COMMERCE
SMALL BUSINESS
SELECT COMMITTEE ON AGING

December 11, 1985

Mr. Norman Siefken
Taylor Lumber & Treating, Inc.
P.O. Box 567
Beaverton, OR 97075

Dear Norm:

Thank you for your letter informing me that your bonding rates have been raised.

I was very disturbed by the information you presented at the October hearing about the bonding problems faced by many small timber operators. Your letter only serves to show the real-world implications of your testimony.

I have asked my staff to contact the Small Business Administration with regard to its bonding program to see if there is some way to tailor the SBA program so that it can work better for the small timber operator. I would hope these changes could be made administratively; however, if a legislative remedy appears the only means to correct these problems, I would certainly be willing to consider such a solution.

Thanks again for taking the time to write. Please stay in touch and let me know if I may ever be of personal assistance.

With warm regards,

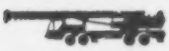
Sincerely,

Ron Wyden

RON WYDEN
Member of Congress

RW/rb

WILLIAMS CRANE, INC.
P.O. Box 68 (605) 892-3116
Belle Fourche, South Dakota 57717



Dec. 23, 1985

DEC 26 1985

Senator Pressler
Washington, S.D. 20510

Dear Senator,

I will be unable to attend your meeting Dec. 30 due to holiday travel. However we are very interested in this insurance problem. In our business it is getting way out of reach and I know other contractors have had to sell out because of the cost of their insurance going up.

I feel one big problem is lawyers are making too much off of lawsuits and jaming up our courts. Have no solutions but feel we must have more regulations on insurance companys and how they invest our premiums. Maybe not be able to cancel a person after one pay off or more no fault policies.

I would like to have a reprot of some kind on the meeting if possible and will be interested in the outcome.

Thank you for your work in Washington on Small Business committee.

Sincerely yours,

Kay Williams

Colonial Penn Insurance Company
5 Penn Center Plaza / Philadelphia, Pennsylvania 19181

Michael D. Monette
Vice President & Counsel
Government Relations
(215) 988-8355

December 20, 1985

VIA TELECOPIER

Hon. Larry Pressler
United States Senate
Russell SOB, 407 A
Washington, D.C. 20510

Re: Cost and Availability of Commercial Liability Insurance
Senate Small Business Committee Public Hearing

Dear Senator Pressler:

Due to previous Holiday commitments, we regret that a Company representative will not be able to attend the December 23 hearing in Sioux Falls. In lieu thereof, we offer the following information for the record.

Colonial Penn is a Pennsylvania domiciled property and liability insurer licensed to do business in South Dakota and all other jurisdictions. Although it is primarily a personal lines writer, the Company elected to enter the public entity (governmental/municipal) commercial property and liability marketplace in late 1983. It is only this line of commercial coverage which has caused us a significant problem in recent months. Therefore, this statement is limited accordingly.

Due to our relative inexperience in this market, our decision to write the business was conditioned upon two factors:

- The availability of adequate reinsurers with experience in the public entity field who would take an active partnership role in the underwriting and management of this business; and
- The availability of an experienced underwriting manager to assist us in developing the business.

Based on the experience and advice of these partners, we decided to write entities which were located primarily in the midwestern and western states. During the course of 1984, we increased our retention to 10%, conservatively reinsuring 90% of the business.

Toward the latter part of 1984, we received notice that some of our reinsurers were planning to withdraw their participation for the 1985 treaty year, while the remaining reinsurers insisted on a total premium limitation in order for them to continue. Nevertheless, it was the opinion of all parties involved that additional reinsurance capacity would be located before mid-year. On that assumption and with our own evaluations of experience and on-site audits, we decided to continue through the first half of 1985, even though this meant accepting a significantly greater net retention in the business.

Much to our surprise, we were unable to find additional reinsurance capacity. Although we diligently pursued the search through our reinsurance intermediaries on an international basis, it was evident by May of this year that adequate reinsurance was not available. For this reason, as a matter of prudent management, we decided to begin the cancellations of our public entity policies, effective on and after July 1, 1985, pursuant to the terms of the coverage. In doing so, however, our search for additional capacity continued in hopes that we would not be forced to terminate the remaining public entity policies with subsequent anniversary dates.

I have attached a printout indicating by name the South Dakota entities which we insured this year, the insureds/coverages that were cancelled and the dates of cancellation. Unfortunately, reinsurers do not look at the individual entity's experience. They only look at the "big picture" before making their decisions. And, as we all know, the picture hasn't been attractive in recent years. For example, our attached South Dakota experience from inception to latest date indicates a combined ratio of 308%. For this reason, we have encountered an acute reinsurance capacity problem on an international scale.

We would like to emphasize that we are not blaming the reinsurers for what has happened in this marketplace. To the contrary, although we cannot speak for the reinsurers, we can conclude from our experience and from what we read in the

trade press that the liability perils are rapidly becoming uninsurable at any affordable price, because the tort system in our litigious society has resulted in ever-increasing and unpredictable, "deep pocket" awards that especially impact governmental and quasi-governmental entities.

Some insurance regulators may counter this observation by contending that blaming the tort system is a "red herring," because industry itself is primarily at fault for indulging excessively in "cash-flow" underwriting. And, the argument concludes, now that investment profits have diminished significantly, industry has been caught with its inadequate rates showing; hence, the primary reason for unprecedented rate increases. There is no doubt that cash-flow underwriting, ironically catalyzed by "excess profits" insurance regulation, was prevalent in recent years and that the practice has contributed significantly to the current rate increase problem. But the rate increase cause-and-effect argument misses the point. In our view, if cash-flow underwriting were the only problem, then rate increases alone would solve the problem. Obviously, this is not the case, because the answer is not that simple. Consequently, we submit that the tort system is the primary problem that concerns both the domestic and international reinsurers. For this reason, we adamantly believe that significant tort reform is essential.

Meanwhile, universal regulator acceptance of the new Insurance Services Office (ISO) commercial general liability policy would be a definite step in the right direction. ISO's program includes innovative concepts, such as defense-cost containment and optional "claims made" coverage, at a corresponding reduction in premium rates. This should alleviate current affordability and availability problems in the marketplace. We commend to you ISO's recently published booklet which fully explains the program.

Unfortunately, another emerging problem concerns insurers and reinsurers: The plethora of recent state laws and regulations that severely restrict terminations. To make things worse, rate limitations and/or open competition repeal is being threatened in several jurisdictions. On the surface, these laws and regulations are designed to protect the consumer . . . a well-intended purpose. But we think that

these developments may adversely impact an already abysmal capacity shortfall, much to the detriment of the consumer. The insurers and reinsurers that are so badly needed in this marketplace will not find the business attractive if they are going to be unreasonably locked into a notoriously volatile risk exposure. Hence, we would strongly suggest moderation in this area.

Although we know that tort reform, MAPs, JUAs, pools, self-insurance and related issues will be explored by the various jurisdictions in an effort to reach a solution, we obviously do not know what the solution will be. But we do know that until reinsurance capacity improves satisfactorily, we will not voluntarily assume an imprudent management position: Accepting exposures which are too great to be absorbed by this Company without adequate reinsurance.

South Dakotans are extremely fortunate to have a very capable and knowledgeable Director of Insurance, Susan Walker. Before leaving the NAIC meeting last week, she shared a few moments of her time with me to discuss these issues. She understands and empathetically appreciates the problems that concern consumers and insurers. I know she has done and will continue to do whatever she can within her power to resolve these problems in an even-handed, common sense manner. Whether federal remedial action also is necessary remains to be seen. But in any event, we commend you and your colleagues for taking the initiative to explore these troublesome issues.

Thank you for the opportunity to offer these comments for the hearing record.

Respectfully submitted,

M. D. Monette

Michael D. Monette

MDM/lat/L/10

cc: Hon. Susan L. Walker
Director of Insurance
State of South Dakota

SOUTH DAKOTA PUBLIC ENTITY EXPERIENCE
(9/1/83 - 9/30/85)

WRITTEN PREMIUM	EARNED PREMIUM	PAID LOSSES & LOSS EXPENSE	PENDING RESERVE	IBNR RESERVE	LOSS RATIO	EXPENSE RATIO	COMBINED RATIO
$919,121	$803,954	$335,318	$1,744,256	$156,318	278.11%	30.0%	308.11%

SOUTH DAKOTA PUBLIC ENTITY BUSINESS

PHC ENTITY CODE / NAME	POLICY #	INCEPT	EXPIR	CANCELED	UND	GL	AL	AP	PR
ATX SD0006 BLUNT CITY OF	PEC400669	7/01/84	7/01/87	7/01/85	DH	X	X		
CNP SD0024 CLAY COUNTY & CLAY COUNTY PARK ASSOC.	PEC400676	1/15/85	1/15/88		DH	X	X	X	
CNP SD0024 CLAY COUNTY & CLAY COUNTY PARK ASSOC.	PEP400329	1/15/85	1/15/88		SE				X
CGJ SD0021 FORT PIERRE, CITY OF	PEP400296	11/23/84	11/23/87		SE				X
AHJ SD0005 FORT PIERRE FIRE FIGHTERS ASSC., INC.	PEP400080	3/24/84	3/24/87		SE				X
CGJ SD0021 FORT PIERRE, CITY OF	PEU400548	11/23/84	11/23/87	11/23/85	DH	X			
AHJ SD0005 FORT PIERRE FIRE FIGHTERS ASSC., INC.	PEC400667	3/24/84	3/24/87		DH	X	X	X	
CGJ SD0021 FORT PIERRE, CITY OF	PEC400673	11/23/84	11/23/87	11/23/85	DH	X	X	X	
ASK SD0007 GRAY GOOSE IRRIGATION DISTRICT	PEC400668	5/11/84	5/11/87		DH	X	X		
ASK SD0007 GRAY GOOSE IRRIGATION DISTRICT	PEU400275	5/11/84	5/11/87	5/31/85	DH	X			
GHT SD0010 HOUSING & REDEVELOPMENT COMMISSION	PEH400175	7/01/84	12/01/85		RB	X			
CTW SD0029 HOVEN, CITY OF	PEC400678	4/01/85	4/01/88		DH	X	X	X	
CDN SD0012 HUGHES COUNTY	PEC400672	11/05/84	11/05/87	11/05/85	DH	X	X	X	
CDN SD0012 HUGHES COUNTY	PEP400292	11/05/84	11/05/87		SE				X
CDN SD0012 HUGHES COUNTY	PEU400549	11/05/84	11/05/87	11/05/85	DH	X			
CPX SD0020 KENNEBEC, TOWN OF	PEC400677	1/29/85	1/29/88		DH	X	X		
CCY SD0020 LAKE NORDEN MRC	PEH400155	7/01/84	11/01/86		RB	X			
CLM SD0022 LEAD, CITY OF	PEI400018	12/31/84	12/31/87		SE				X
CLM SD0022 LEAD, CITY OF	PEC400674	12/31/84	12/31/87		DH	X	X	X	
BHW SD0009 LEMMON PHA	PEH400174	7/01/84	12/13/85		RB	X			
CEG SD0019 MADISON CITY HOUSING AND REDEVELOPMENT	PEH400103	7/01/84	10/06/85		RB	X			
BHW SD0015 MURDO PHA	PEH400030	7/01/84	7/01/86	9/20/85	RB	X			
BHU SD0011 PIERRE PHA	PEH400173	7/01/84	12/07/85		RB	X			
CNO SD0027 PIERRE, CITY OF	PEP400352	1/14/85	1/14/88		SE				X
CNO SD0027 PIERRE, CITY OF	PEC400679	1/14/85	1/14/88		DH	X	X	X	
ACY SD0004 SOUTH DAKOTA STATE E	PEC400665	12/01/83	12/01/86		DH	X	X	X	
ACT SD0003 SOUTH DAKOTA BUILDING AUTHORITY	PEC400664	11/18/83	11/18/86	11/18/85	DH	X	X		

SOUTH DAKOTA (CONT.)

Page 2

PHC ENTITY CODE / NAME	POLICY #	INCEPT	EXPIR	CANCELED	UND	GL	AL	AP	PR
ACY SD0004 SOUTH DAKOTA STATE E	PEC400666	12/01/83	12/01/86		OH	X	X		
ACY SD0004 SOUTH DAKOTA STATE E	PEB400001	12/01/83	12/01/86		SE				X
ACY SD0004 SOUTH DAKOTA STATE E	PEP400395	12/01/84	12/01/85		SE				X
ACY SD0004 SOUTH DAKOTA STATE E	PEP400343	12/01/84	12/01/87	12/01/84	SE	X			X
ACT SD0003 SOUTH DAKOTA BUILDING AUTHORITY	PEF400002	11/18/83	11/18/86		SE				X
BSN SD0018 STANLEY COUNTY	PEP400269	10/14/84	10/14/87		SE				X
BSN SD0018 STANLEY COUNTY	PEU400476	10/14/84	10/14/87	10/14/85	OH	X			
BSN SD0018 STANLEY COUNTY	PEC400670	10/14/84	10/14/87	10/14/85	OH	X	X		
BZS SD0017 STANLEY SCHOOL DISTRICT #57-1	PEC400671	11/01/84	11/01/87	11/01/85	OH	X	X	X	
BZS SD0017 STANLEY SCHOOL DISTRICT #57-1	PEU400529	11/01/84	11/01/87	11/01/85	OH	X			
BZS SD0017 STANLEY SCHOOL DISTRICT #57-1	PES400196	11/01/84	11/01/87	11/01/85	OH	X			
BZS SD0017 STANLEY SCHOOL DISTRICT #57-1	PEP400271	11/01/84	11/01/87		SE				X

Coverage Key:

General liability (GL)
Auto liability (AL)
Auto physical damage (AP)
Property (PR)